C. P. A. QUESTIONS AND ANSWERS

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FOREWORD

This book is designed for all persons engaged in the study or practice of accountancy, including students of accounting, bookkeepers, auditors and professional accountants. It should be of special value, however, to candidates for C. P. A. examinations.

The answers to questions on Theory of Accounts, Practical Accounting and Auditing comprise, with a few exceptions, my regular contributions to BUSINESS magazine for the five years from 1909 to 1913 inclusive—the exceptions referred to, and the Business Law questions, were prepared under the supervision of Mr. F. W. Morton, Director of The International Accountants' Society, and during those years Editor of said magazine.

The practical accounting problems are of special interest, since they comprise some of the most important questions set by the Examining Boards of the United States and Canada; in fact they include some of the most difficult propositions to be met with in the active work of the professional accountant. The solutions and explanations, however, are, in many cases, more lengthy and exhaustive than would be required in an examination because in this way they provide not mere answers to questions, but complete lessons on the subjects under discussion.

In presenting this publication it is hoped that it may be of service in answering many of the questions which are continually arising in the actual practice of business. Suggestions and frank criticisms of persons discovering the need of such, are cordially invited in order that improvements may be made in succeeding editions.

R. J. BENNETT, C. P. A.

Philadelphia, January 1, 1914.

Contents

Introductory

IN THE SELECTION of these problems our endeavor has been to cover in a general way the nature of the questions which have been heretofore, and are now being set at the regular C. P. A. examinations in the various states. The explanations given are, in some cases, much broader than would ordinarily be required in an examination, but the object of this work is to give the reader not only a method of solving such problems, but enough real meat to be of permanent educational value to him. In fact, many of the solutions are designed to serve as complete lessons on the subjects treated. A model C. P. A. Bill is included for the purpose of giving the reader a general knowledge of the usual requirements of the State Laws, although the details may vary to a slight extent in the different states.

In the arrangement of the various questions and answers it has seemed advisable to subdivide them into the four sections usually covered, i. e., Theory of Accounts, Practical Accounting, Auditing, and Commercial Law. A complete set of questions is first presented in order to indicate the scope of a C. P. A. examination; these questions are then followed by answers to the questions on Theory of Accounts presented therein.

Part two covers a series of selected Practical Accounting problems pertaining to different lines of business and requiring elucidation of the various exhibits, statements and adjustments used by accountants; these comprise Statistical Records, Revenue Reports, Profit and Loss Statements, Balance Sheets, Comparative Statements, Consignment Accounts, Corporation Entries, Insurance Adjustments, Mergers and Amalgamations, Bond Issues, etc.

It is somewhat difficult to draw a distinct line of demarcation between Practical Accounting questions and those pertaining to Auditing, since the work of a professional Auditor necessarily involves and presupposes a thorough knowledge of practical accounting procedure, and it should be kept in mind that one of the most important duties of an auditor is to satisfy himself that correct accounting principles have been followed in the keeping of the accounts themselves, as well as in the preparation of revenue and financial statements. The third section, therefore, not only covers a complete set of questions on Auditing as used in a recent C. P. A. examination, but goes into the

practical end of the work by presenting illustrations of auditors' reports accompanied by the necessary statements and exhibits.

The Commercial Law questions have been selected from those used in a great many different states, and while more or less general in their nature, can all be used as the basis of answers to questions on smilar subjects. The authors are indebted to Hon. Chas. C. Simons, L.L.B., author of Commercial Law Simplified for a great deal of help in the selection and arrange ment of the problems included in this fourth section.

Public Accountants are endeavoring, through National and State Associations, to maintain high standards of efficiency in their work as well as in their professional conduct, and in recent years it has been the endeavor of examining boards in the various states to prepare questions of a uniformly high character in order to create not only a higher grade of accountants, but to inspire in the minds of the general public a greater degree of confidence in the accounting profession.

To those who are earnestly striving to advance the already high standard and general efficiency of the profession of accountancy, this book is respectfully dedicated.

C. P. A. Questions and Answers

Model C. P. A. Bill

APPROVED AND RECOMMENDED BY THE EXECUTIVE BOARD OF THE FEDERATION OF SOCIETIES OF PUBLIC ACCOUNTANTS IN THE UNITED STATES OF AMERICA.

THE STATE BOARD OF ACCOUNTANCY BILL.

Title.

A BILL for an Act to create a State Board of Accountancy and to prescribe its powers and duties, to provide for the examination of and issuance of certificates to qualified accountants, and to provide a penalty for violation of this Act.

Note "a."—This heading is an adaptation of the headings of the Pennsylvania, California and Washington laws. The idea is to designate fully in the title what the scope of the bill is. Bills are very often read by their title only, and their disposition is based entirely upon the impression gained from the title. C. P. A. bills simply providing for the regulation of the profession have been referred to the wrong committee, for the reason that the Speaker of the House jumped at a wrong conclusion in regard to the bill because the title was not sufficiently explicit. This is an important point and should be carefully handled.

Section I.

Be it enacted by the people of the State of........................., represented in the General Assembly, that any citizen of the United States, or person who has duly declared his intention of becoming such citizen, having a place for the regular transaction of business as a professional accountant, in the State of....................... (see note "b"), being over the age of twenty-one years (see note "c"), of good moral character, being a graduate of a high school with a four years' course, or having had an equivalent education (see note "d"), who shall have received from the State Board of Accountancy (see note "e") a certificate of his qualifications to practice as a public expert accountant as hereinafter provided, shall be styled and known as a Certified Public Accountant; and no other person shall assume such title, or use the abbreviation "C. P. A." or any other words or letters to indicate that the person using the same is such Certified Public Accountant. (See note "f".)

Note "b."—It is regarded as an essential point that any person who is to receive a C. P. A. certificate should have a place for the regular transaction of business as a professional accountant within the State.

The New York, Pennsylvania, Maryland and California laws provide for any person residing in the State, or having a place of business; this opens the door

to persons who are not actually engaged in the practice of accountancy as a profession.

The Illinois law requires that applicants for certificates shall be actually practicing accountants and have a place of business within the State. This is regarded as very necessary.

Note "c."—It is necessary to fix the age limit at the legal age of 21 years. Some attempt has been made from time to time to fix the age limit at 25 years, but these efforts have not been successful. In the Washington Bill the age limit was set at 25 years, but was amended on the floor of the house on second reading to 19 years by a member who thought that any boy coming out of College ought immediately to be allowed to take this examination. Outside of Washington all the laws passed have a 21-year age limit.

Note "d."—The wording here is copied from the Illinois statute and specifically calls for a high school education, or the equivalent.

The New York law does not specify that there shall be a preliminary education, but the Regents in framing rules for the examination of candidates have insisted on a high school graduation, or four years academic study or the equivalent.

No laws except Illinois provide, in the statute, for any preliminary education, but it is regarded as desirable, even if not essential, that this provision should be embodied in the bills that will hereafter be promulgated, in order that a standard may be maintained which will be on a par with the older States.

Applicants under the Waiver Clause do not have to comply with this requirement.

Note "e."—The State Board of Accountancy is made the grantor of the Certificates. This is the law in California and Washington, while in Pennsylvania and Maryland the Governor grants the certificates and in New York and Illinois the State University does this.

It is a debatable point whether the granting power should be with the Governor or with the State Board of Accountancy. The less the Governor has to do with the matter the better it is in most States, as it is desirable to keep out politics as much as possible.

Note "f."—The wording "note e" as far as the end of the first section is identical with the New York, Pennsylvania, Maryland and Illinois laws, and is practically the same as California and Washington. This is the vital part of the whole bill and should be uniform in all States. It is recommended that the exact wording as already established in the four principal States be adhered to.

Section II.

The Governor shall, within 30 days after the passage of this Act, appoint three persons (see note "g"), who shall be skilled in the practice of accounting and actively engaged therein on their own account in the State of..........................to constitute and serve as a State Board of Accountancy (see note "h"). The members of such Board shall hold office for three years and until their successors are appointed and have qualified, except that one of the members of the State Board of Accountancy, first to be appointed under this Act, shall hold office for one year, and one for two years. (See note "i".) Upon the expiration of each of said terms an examiner shall be appointed for the term of three years, and after the year one thousand nine hundred and ...... the examiners shall be appointed from the holders of certificates issued under this Act. (See note "j".)

Note "g."—It is recommended very strongly that the law should call for a Board of three examiners and no more, for the reason that three persons are found to be sufficient and a larger number is difficult to secure and more difficult to deal with. In New York and Illinois there are three Examiners; in Maryland the Board is composed of four persons, and in Pennsylvania, California and

Washington of five persons. It is very seldom that more than three persons can be found to take sufficient interest in the workings of such a law as this to make their services of any value at all.

Note "h."—It is desirable that the examiners should be chosen from men who have been actively engaged in the State as public accountants for a period of years. In Pennsylvania, of the five examiners three must have been in practice as public accountants for at least five years. In Maryland two of the examiners must be selected from a list of those names proposed by the Maryland Association of Public Accountants. In Illinois the University appoints the three examiners, two of whom "shall be skilled in the practice of accounting and actively engaged therein in the State." In California the Governor appoints five persons, "at least three of whom shall be competent and skilled public accountans, or shall have been practicing as such in this State for not less than five consecutive years." Washington has the same as California, except that three years' practice is sufficient.

Note "i."—The plan here suggested is that adopted in other States and provides for the continuity of the Board, which is very essential.

Note "j."—In some of the C. P. A. Laws a great deal more is said in regard to the examining Board, especially in Pennsylvania and Maryland, but it is believed that the provisions contained in the above section are ample to cover the essentials.

Section III.

The State Board of Accountancy shall make rules for conducting the examinations to be held under this Act. Said examinations shall be held at least once a year. The examinations shall be in "Theory of Accounts," "Practical Accounting," "Auditing" and "Commercial Law as affecting accountancy."

Note "k."—The essential feature in the above section is the wording of the branches of the examination. These are the same in every law that has been passed, except that the words "Commercial Law" stand alone outside of Illinois, the words "as affecting accountancy" having been added in drawing up the Illinois law, so as to avoid any antagonism from the legal fraternity; the idea being that members of the legislature, which is largely made up of lawyers, would resent the appointment of a Board of accountants to hold examinations in law. This is thought to be a god point and, as the words interpolated in Illinois do not injure the section but rather help define it, it is recommended that they should be generally adopted.

Section IV.

The State Board of Accountancy shall charge for the examination and certificate provided for in this Act, a fee of $25.00, to meet the expenses of such examinations. This fee shall be payable by the applicant at the time of filing his application. (See note "l".) The State Board of Accountancy shall report annually the number of certificates and the receipts and expenses under this Act to the Governor. (See note "m".)

Out of the funds collected under this Act shall be paid the actual expenses of the State Board of Accountancy in conducting such examinations and issuing such certificates, and an amount not exceeding $10 per day to each member of said Board, for the time actually expended in pursuance of the duties imposed upon them by this Act, provided that no expenses incurred under this Act shall be a charge upon the funds of the State. (See note "n".)

Note "l."—The only essential feature in this section is that the fee to be charged for the examination and certificate shall be the sum of $25. This is the universal fee charged in all States, although some of the laws read that the Board shall charge for examination and certificate such fee as may be necessary to meet the actual expenses of such examination and issuing of such certificates. It is thought better that the fee of $25 should be specified in the Act.

Note "m."—It is immaterial to the Federation whether the State Board of Accountancy reports to the Governor or to the State Comptroller, or does not report at all; also as to what facts are reported in this way.

The New York law compels the Regents of the University to report annually to the State Comptroller, and pay the balance of receipts over expenditures to the State Treasurer. The Pennsylvania law says that any surplus over and above expenses shall be turned "into the Treasury of the Commonwealth," also that the results of the examinations shall be certified to the Governor.

The Maryland law provides that the Board of Examiners shall report to the State Comptroller and pay the surplus into the State Treasury. The Illinois law allows the University to collect the fees, pay the expenses and keep the net revenue, if any.

In this connection it must be borne in mind that only during the first year after the passage of the Act is any large amount of income likely to arise. This is in respect to the large number of applications that will probably be made under the Waiver Clause. In subsequent years, when the income is very little, the expenses of holding the examinations are much more and the income is likely to be short.

Note "n."—It is desirable to establish, in the face of the bill, what the remuneration to be paid to the members of the State Board of Accountancy shall be, and $10 per diem is the rate that has usually been established. In California and Washington the remuneration is only $5 a day.

Section V.

The State Board of Accountancy may, in its discretion, register the certificate of any Certified Public Accountant who is the lawful holder of a C. P. A. certificate issued under the law of another State, and may issue to such Certified Public Accountant a certificate of registration, which certificate shall entitle the holder to practice as such Certified Public Accountant and to use the abbreviation C. P. A. in this State. Provided, however, that such other State extends similar privileges to Certified Public Accountants of this State. The State Board of Accountancy may charge for such certificate of registration such fee as may be necessary to meet the expenses of such registration.

Note "o."—This is an important section and a new one. It is recommended by the Federation and has for its object the free intercourse of C. P. A.'s between States under certain carefully arranged conditions as to registration.

Seection VI.

The State Board of Accountancy may, in its discretion waive the examination of any person possessing the qualifications mentioned in Section I. of this Act who shall have been for more than one year before the passage of this Act practicing in this State on his own account as a public accountant and who shall apply in writing to said Board for such certificate within one year after the passage of this Act. (See note "p".)

Note "p."—The above is the Waiver Clause and is the most important in the whole bill and open to the most discussion. The wording used above is quoted from the New York law, subject to some change in detail.

In New York the face of the law calls for one year's previous practice, but when the Regents of the University made rules for holding the examinations they insisted upon five years previous experience and this caused a great deal of trouble. Subsequently, another bill was passed reopening the Waiver Clause and under this second bill everybody who had been practicing as an accountant for one year prior to 1896 and who made application before September 1st, 1901, was admitted under the Waiver Clause.

In Pennsylvania the Waiver Clause admits an accountant who has had three years previous practice on his own account. In Maryland a person must have been practicing at the time of the passage of the Act, but he need not have had any years of practice.

In Illinois "five consecutive years previous experience as a public accountant" is demanded. In California "more than three years" previous experience is required. In Washington previous experience is not stipulated, any resident of the State being available at the discretion of the Board.

Section VII.

The State Board of Accountancy may revoke any certificate issued under this Act, or may cancel the registration of any certificate registered under this Act, for unprofessional conduct of the holder of such certificate, or other sufficient cause, provided that written notice shall have been mailed to the holder of such certificate twenty days before any hearing thereon, stating the cause for such contemplated action and appointing a day for a full hearing thereon, by the State Board of Accountancy, and provided further that no certificate, issued under this Act, shall be revoked until such hearing shall have been held. (See note "q".)

Note "q."—This section is long and appears complex. It is adapted from the Illinois law, amended so as to embrace the cancellation of registration of certificates issued by other States. If this section ever becomes operative it is most essential that the wording should be very explicit. In the event that a C. P. A. of an outside State, having secured registration under this Act, should be guilty of unprofessional conduct a means must be provided by which he may be dealt with by the State Board of Accountancy.

Section VIII.

If any person shall represent himself to the public as having received a certificate as provided in this Act, or shall assume to practice as a Certified Public Accountant, or use the abbreviation C. P. A. or any similar words or letters to indicate that the person using the same is a Certified Public Accountant, without having received such C. P. A. certificate, or without having received a registration certificate, as provided in this Act, or if any person having received any certificate, as provided in this Act, and having thereafter lost such certificate by revocation as herein provided, shall continue to practice as a Certified Public Accountant, he shall be deemed guilty of a misdemeanor and upon conviction thereof shall be fined a sum not exceeding two hundred ($200.00) dollars for each offense.

Note "r."—This Penalty Clause is strongly recommended as being definite and specific. In New York the Penalty Clause reads, "Any violation of this act shall be a misdemeanor."

The Maryland law provides a penalty of $200 or six months in jail for any one convicted of violating the provisions of the Act. The California law copies New York, and the Washington law provides for a fine of $100 for violation of the Act.

Complete Set of Questions

EXAMINATION IN THEORY OF ACCOUNTS.

Time limit, four hours.

Answer fourteen (14) questions, but no more. Questions 5 or 7 elective, balance obligatory. Do not repeat the questions, but designate by respective numbers. Your mark will be based on one-half of total points, shown opposite each question, for correct answers, to which will be added such as you may obtain of a maximum 25 points for "form, expression and knowledge evidenced of the principles involved."

1. Name any business with which you are familiar and state how you would instruct your client to charge interest on:

    (a) Money borrowed to build additions to the plant.

    (b) Money borrowed to pay current bills.

2. Following up your answers to the above, what effect will such instructions have on the annual Statement of Operations and the Condensed Balance Sheet in the respective cases of (a), (b).

3. What, if any, is the difference between the Income and Receipts of a business?

4. What, if any, is the difference between Expenses and Disbursements?

5. (a) How would you arrange the following accounts in the Condensed Balance Sheet of the E. and F. Corporation?

E and F Corporation First Mortgage Bonds issued; Funds advanced for traveling expenses; Addition to Mill No. 7, Plant No. 1; Advances to employes on current payroll; Real Estate, Buildings and Equipment, Plant No. 2; E. and F. Corp. Bonds Unsold; Furniture and Fixtures, Plant No. 1; Accounts Payable, secured by a lien on machinery; Accounts Payable, Sundry unsecured creditors; Box and Veneer Plant, Plant No. 1; Store and Office Fixtures, Plant No. 2; Sawmill and Dry Kilns, Plant No. 3; Electric Plant, Plant No. 1; Furniture and Fixtures, N. Y. office; Notes Payable, secured; Customers' Accounts, receivable; Depreciation Reserve Account; Logs, Boxes and Veneer, Plant No. 1; Interest paid in advance; Wharves and Warehouses, Plant No. 3; Freight Unpaid; Capital Stock, E and F Corp.; Notes Receivable; Real Estate, Plant No. 1; Undivided Profits; Notes Payable; Boxes, Lumber, etc., Plant No. 2; Lumberman's Marine Insurance Co., Stock; Sinking Fund Invested; A. C. L. R. R. Co., Bonds; Timber Lands and Stumpage; Cash, Plant No. 1; Teams and Carts; Lumber and Logs, Plant No. 3; Cash, Plant No. 3; Cash, Plant No. 2; Insurance Premiums Unearned; Dividends Unpaid; Surplus; Real Estate, Plant No. 3; Cash, N. Y. Office; N. & W. R. R. Co., Bonds; Current Profits; Payrolls, Due and Unpaid.

    (b) State your reason for the arrangement you have made in answer to the above questions.

    (c) Which items would you designate as Current or Quick Assets?

6. (a) What may the placing of an item on the debit side of a ledger account represent?

    (b) What may the placing of an item on the credit side of the ledger account represent?

7. In looking over the accounts of a firm you find that practically all of their Accounts Receivable had been paid, a large part of the settlements being by customers' notes. The Bills Receivable Account was in balance, but reference to the Bills Receivable Record showed that about $27,000 was being carried by the banks on this company's endorsement. State fully the method you would suggest to the proprietor that his books should at all times show the entries necessary from the first receipt of a note until it was finally paid, when:

(a) It is paid by the maker at maturity.
(b) It is partially paid and a new note given for the balance.
(c) It is protested for non-payment at maturity.
(d) It is taken up, with a new note of the same amount, with interest added, at maturity.

8. (a) What books of record are necessary, in addition to the books of account, for a corporation existing under the laws of this state?
(b) Of what value would such records be at the time of an audit?

9. (a) What is the purpose of a depreciation account?
(b) Give an illustration showing the entries needed to bring it into the ledger accounts.

10. What may goodwill represent?
11. What constitutes Manufacturing cost?
12. What constitutes selling cost?
13. What expenses would you classify as Fixed or Overhead?
14. What is a Balance Sheet?
15. How does it differ from a Statement of Assets and Liabilities?

EXAMINATION IN PRACTICAL ACCOUNTING.

Time limit, four hours.

QUESTION NO. 1.

The Fairfax Foundry Company, a Virginia corporation, owns and operates an iron foundry, a valve and hydrant shop and a machine shop, and also owns some undeveloped ore lands. Three-fifths of the capital stock (which is all common) is owned by A. Pluto Kratt and other capitalists, while the balance is owned by A. B. Etterman. The business was, at one time, very profitable, but the net earnings have declined steadily since 1905, until, in 1910, the result of operation showed a loss. The business during the early months of 1911 being still more unsatisfactory, overtures were made by Etterman to purchase enough additional stock to give him control, with a view to changing the management. Etterman offered $70.00 a share for 1,000 shares, or more; but Kratz and his associates demanded $90.00 per share.

At this point you are called in by Etterman to audit the Company's books from January 1, 1911, to September 30, 1911; to verify the cost of plant and ore properties, and to set a valuation on the accounts receivable. You find that $2,909.95 of the latter are worthless and that, in 1905, Plant Account was inflated $200,000 to cover an issue of watered stock. Otherwise the books correctly show the Company's condition, as follows:

Trial Balance, September 30, 1911.

Cash	$ 22,034 32	
Accounts Receivable (good)	132,413 82	
Accounts Receivable (uncollectible)	2,909 95	
Plant and Equipment	732,480 27	
Reserve for Plant Depreciation		$ 123,275 00
Ore Properties	55,017 09	
Bills Payable		165,652 37
Accounts Payable		40,710 29
Capital Stock		500,000 00
Surplus		272,605 18
Inventory, January 1, 1911	78,831.68	
Foundry Sales		507,985 84
Valve and Hydrant Sales		77,534 65
Machine Shop Sales		56,385 11
Foundry Material and Freight	396,413 57	
Valve and Hydrant Material and Freight	63,326 87	
Machine Shop Material and Freight	16,779 95	
Foundry Labor	102,139 37	
Valve and Hydrant Labor	12,826 21	
Machine Shop Labor	26,617 36	
Foundry Expense	5,766 04	
Valve and Hydrant Expense	2,893 31	
Machine Shop Expense	1,667 26	
Foundry Commissions	2,388 05	
Valve and Hydrant Commissions	862 14	
Machine Shop Commissions	252 58	
Foundry Repairs and Renewals	32,568 23	
Valve and Hydrant Repairs and Renewals	6,067 80	
Machine Shop Repairs and Renewals	3,229 82	
General Salaries	25,376 08	
General Expense	9,672 51	
Legal Expense	693 04	
Taxes	1,957 50	
Insurance	3,195 90	
Advertising	176 15	
Interest	5,591 57	
	$1,744,148 44	$1,744,148 44

Analysis of Inventory of January 1, 1911:

Foundry—	
Raw material and goods in process	$ 29,322 11
Finished goods	17,387 52
Valve and Hydrant—	
Raw material and goods in process	8,690 20
Finished goods	13,839 45
Machine Shop—	
Raw material and goods in process	7,899 73
Finished goods	1,692 67

Inventories, Prepayments and Accruals, September 30, 1911 (not yet entered):

Inventory:	
Foundry—	
Raw material and goods in process	$ 36,490 62
Finished goods	31,414 36
Valve and Hydrant—	
Raw material and goods in process	13,562 95
Finished goods	20,389 61
Machine Shop—	
Raw material and goods in process	9,603 82
Finished goods	1,713 65
	$113,175 01
Unexpired Insurance	$ 482 68
Prepaid Taxes	$ 387 60
Accrued Wages:	
Foundry	$ 3,084 26
Valve and Hydrant Shop	514 03
Machine Shop	1,542 09
	$ 5,140 38
Unpaid Freight:	
Foundry	$ 256 78
Valve and Hydrant Shop	28 25
Machine Shop	9 45
	$ 294 48

Prepare Manufacturing, Trading, and Profit & Loss Accounts for the nine months ended September 30, 1911, and Balance Sheet showing the Company's condition (based on Ledger value of plant) at that date. Embody them in a report to your client, with such explanation and comment as you think proper.

A few days after the submission of your report, a compromise is effected on the following basis:

Kratz, et al, sell their $300,000 common stock at 90, taking in exchange therefor:

$200,000 new 6 per cent preferred stock, at par	$200,000 00
The Company's ore lands at a valuation of	60,000 00
Cash	10,000 00
	$270,000 00

Etterman buys $100,000 common stock, at 70	$ 70,000 00
The Company receives cash	$ 60,000 00
For ore lands carried at	55,017 09
Realizing a profit of	$ 4,982 91

The Company's counsel directs that the deal be consummated in the following manner:

Kratz, et al, to deliver to the Company $200,000 common stock (to be retired) in exchange for $200,000 new six per cent preferred stock.

Etterman to pay the Company $60,000, in return for which the Company will issue to Kratz, et al, a deed for the ore lands.

Etterman to pay Kratz, et al, $10,000 and receive from them the remaining $100,000 of their common stock.

Draft the Journal and Cash Book entries necessary to record such of the above transactions as should appear in the books of account.

QUESTION NO. 2.

The stockholders of A Company and B Company have decided to form a new corporation (C Company), which is to take over all the assets and assume all the liabilities of both the old companies. The holders of Preferred Stock of the old companies are to receive an equal number of shares of Preferred Stock of the new company. The holders of Common Stock are to take Common Stock of the new company at par, to an amount equal to the book value of their holdings in the old companies. Before determining the book value of the old Common Stock, however, an amount equal to two per cent of the Accounts and Bills Receivable of each company is to be deducted from its Surplus and carried to a Reserve Account, to provide for contingent losses.

The condition of the old companies is as follows:

Assets.

	A Co.	B Co.
Cash	$ 20,231 74	$ 43,123 81
Accounts Receivable	296,059 14	759,911 06
Bills Receivable	8,245 08	35,342 09
Merchandise Inventory	212,636 81	393,937 46
Land and Buildings	42,689 42	174,156 97
Machinery	31,222 97	69,160 35
Furniture and Fixtures	2,500 00	5,000 00
Investments	8,000 00	4,550 00
Prepaid Taxes and Insurance	1,014 20	2,346 48
	$622,599 36	$1,487,528 22

Liabilities.

Accounts Payable	$204,669 18	$ 244,168 44
Bills Payable	86,844 10	227,454 72
Preferred Stock	100,000 00	200,000 00
Common Stock	150,000 00	400,000 00
Surplus	81,086 08	415,905 06
	$622,599 36	$1,487,528 22

The holders of Common Stock in the old companies are as follows:

	A Co.	B Co.
Smith	400 shares	1,200 shares
Jones	300 shares	
Brown	150 shares	
Black	50 shares	2,000 shares
White	600 shares	
Green		500 shares
Henry		300 shares
	1,500 shares	4,000 shares

Draft the Journal entries necessary to create the Reserve Accounts in the books of each of the old companies.

Show the final book value of Common Stock of each of the old companies.

Show the number of shares of Common Stock of the new company to be received by each of the holders of Common Stock of the old companies.

Prepare a Balance Sheet, showing condition of C Company, after taking over the assets and liabilities of the old companies.

QUESTION NO. 3.

On January 1, 1911, the condition of the Goodrich Manufacturing Company was as follows:

Assets.

Cash	$ 7,962 42
Accounts Receivable	81,249 52
Bills Receivable	6,244 73
Merchandise Inventory	55,811 88
Machinery	14,551 21
Furniture and Fixtures	2,168 75
Unexpired Insurance	411 21
	$168,399 72

Liabilities.

Accounts Payable	$ 48,343 90	
Bills Payable	30,000 00	$ 78,343 90
Capital Stock	$ 60,000 00	
Surplus	30,055 82	90,055 82
		$168,399 72

On the night of January 27, 1911, they were burned out. The merchandise, furniture and fixtures were a total loss, and the salvage in the machinery was valued at $4,000.

Their Ledger, at the close of business on January 27, 1911, showed the following balances:

	Dr.	Cr.
Capital Stock		$ 60,000 00
Surplus		30,055 82
Cash	$ 6,182 49	
Accounts Receivable	70,870 36	
Bills Receivable	7,874 48	
Accounts Payable		46,504 56
Bills Payable		25,000 00
Machinery	14,701 21	
Furniture and Fixtures	2,208 75	
Inventory, January 1, 1911	55,811 88	
Dividends	6,000 00	
Sales		26,161 87
Merchandise Purchases	14,080 43	
Labor	5,996 17	
Power, Light and Heat	342 72	
Factory Expenses	742 55	
Office Salaries	1,650 00	
Office Expenses	98 62	
Selling Expenses	751 38	
Insurance	411 21	
	$187,722 25	$187,722 25

The books show that ten per cent has been written off from Machinery and Furniture and Fixtures on December 31st of each year, since the business was started; also, that the Gross Profit on Sales has been very uniform and has averaged twenty per cent.

The insurance carried, covering Merchandise, Machinery, Furniture and Fixtures, was $70,000.

Prepare a statement showing the amount of the Goodrich Manufacturing Company's claim against the insurance company, assuming that the former retains the damaged machinery at the appraised value of $4,000.

QUESTIONS 4 & 5.

Time limit, three and one-half hours.

4. Charles Cabell, William West and Henry Hart form a partnership for the purpose of engaging in the manufacture of plug and smoking tobaccos. Cabell invests $75,000, West $50,000, and Hart $25,000. Profits or losses are to be shared as follows: Cabell 1-2, West 1-3, and Hart 1-6. Interest is not to be allowed on capital, nor charged on withdrawals, but each partner's withdrawals during any one year are not to exceed one-tenth of his capital in the business.

At the end of their first fiscal year their Ledger shows the following balances:

	Dr.	Cr.
Charles Cabell, Capital Account		$ 75,000 00
William West, Capital Account		50,000 00
Henry Hart, Capital Account		25,000 00
Charles Cabell, Withdrawal Account	5,842 17	
William West, Withdrawal Account	4,179 16	
Henry Hart, Withdrawal Account	2,033 88	
Machinery	11,026 92	
Land and Buildings	25,000 00	
Furniture and Fixtures	1,866 13	
Cash	8,730 45	
Accounts Receivable	131,244 49	
Bills Receivable	4,999 97	
Accounts Payable		6,138 16
Bills Payable		118,060 62
Sales—Plug Tobacco		249,472 43
" Smoking Tobacco		61,882 25
" Stems		841 95
Leaf Tobacco	200,044 57	
Licorice and Flavoring	21,918 66	
Boxes	8,572 10	
Labor	25,182 47	
Stamps	48,476 24	
Power, Light and Heat	3,571 60	
Factory Expense	7,380 55	
Hauling	1,451 30	
Salaries	12,443 71	
Office Expense	4,228 87	
Insurance	1,682 90	
Interest and Discount	9,164 47	
Postage	1,211 97	
Attorneys' Fees	769 25	
Salesmen's Salaries, Commissions, etc	38,795 15	
Advertising	5,149 09	
Lost Accounts	1,429 34	
	$586,395 41	$586,395 41

Ten per cent is to be charged off from Machinery Account, to cover depreciation, and a Reserve equal to 2 per cent of the Accounts and Bills Receivable is to be created, to cover possible undeveloped losses.

The unexpired insurance premiums amount to $331.11.

Inventories are as follows:

Finished Goods	$ 38,189 42
Goods in Process	11,209 35
Leaf Tobacco	49,128 98
Licorice and Flavoring	1,511 68
Boxes	1,073 04
Stems	43 31

Draft Journal entries for closing the books (separating Profit & Loss Account into Manufacturing, Trading, and Profit & Loss Divisions) and prepare Balance Sheet.

5. Henry Dearborn died, leaving one daughter (Virginia) and two sons (Robert and Thomas), all of whom are of age. The will directs that the estate be distributed in equal shares. The estate consists of:

Cash in bank	$ 3,000 00
$10,000 Southern Ry. 4s, appraised at	10,000 00
$5,000 Pennsylvania R. R. 3½s, appraised at	4,800 00
Furniture, appraisal at	800 00
Horse, Carriage and Harness, appraised at	500 00

The executor has disposed of the above as follows:

Southern 4s, sold for	$10,500 00
P. R. R. 3½s, sold for	4,750 00
Furniture, sold for	1,050 00
Horse, Carriage and Harness, sold for	375 00

Interest has been collected:

On Southern Ry. Bonds	$ 450 00
On Pennsylvania R. R. Bonds	87 50
On bank balances	72 00

The executor has paid:

Funeral expenses	$ 500 00
Decedent's debts	800 00
Counsel fees, etc.	325 00
Safe deposit box rent	10 00
Virginia Dearborn, account distribution	1,000 00
Robert Dearborn, account distribution	1,000 00
Thomas Dearborn, account distribution	1,000 00

State executor's first and final account, with distribution account attached.

EXAMINATION IN AUDITING.

Time limit, three and one-half hours.

Answer eight (8) questions, but no more. Questions 4 or 5 elective, balance obligatory. Do not repeat the questions, but designate by respective numbers. Your mark will be based on one-half of total points, shown opposite each question, for correct answers, to which will be added

such as you may obtain of a maximum 25 points for "form, expression and knowledge evidenced of the principle involved."

1. Describe fully: (a) Capital expenditure; (a-2) Illustrate; (b) Revenue Expenditure; (b-2) Illustrate; (c) Capital Receipts; (c-2) Illustrate; (d) Revenue; (d-2) Illustrate; (e) Quick or Current Assets; (e-2) Illustrate.

2. What is the purpose of a Realization Account or Statement?
   (b) When is such necessary?

3. A & Co. acquire the plants of B, C, D, and E, assuming their Assets and Liabilities at book values, the purchase price being one-half of the amount shown by the surplus account of each. Without going into lengthy detail, but just considering the three items, Assets, Liabilities, and Surplus, what entries would you make to set up these accounts in the ledger of A & Co.?

4. If it was found, after acquiring the above plants, that large amounts had to be expended in improvements to bring the plants up to their rated efficiency:

   (a) Give a concise, but full, explanation of how you would classify such expenditures, naming the accounts you would debit and credit.

   (b) Would such expenditures have any relation to the 50 per cent equity A & Co. were supposed to have purchased?

   (c) State your reasons for the preceding answer.

5. Describe in full the plan you would follow to audit the accounts of any business with which you are familiar, it being presumed that they use a General Ledger, Sales Ledger, Purchase Ledger,Distributive Sales Journal, Distributive Purchase Journal, Ordinary Journal and Cash Book. Funds are handled through two banks by regular form of check.

6. State briefly, but clearly, the methods you employed to conduct an audit on which you have actually been engaged.

7. (a) At what valuation should the inventory of any company be computed?

   (b) Explain fully.

8. In computing manufacturing costs, covering a definite period of operation, should the quantity sold or the quantity produced be taken as the basis for ascertaining the average cost of each operation?

   (b) Explain.

   (c) Illustrate your argument.

9. How would you audit a cash account, assuming that all the entries were shown by the Cash Book, or by the Cash Book and Bank Pass Book, or by the Cash Book, Bank Pass Book and Check Book, when all the receipts were checks and short term notes, and all the disbursements were by checks.

EXAMINATION IN COMMERCIAL LAW.

Time Limit Three and One-Half Hours.

Answer ten (10) questions, but no more. Do not repeat questions, but write answers only, designating the questions by number.

1. A purchases of B a lot and gives his negotiable note for $5,000, part of the purchase price. Before maturity of the note, B borrows of X National Bank $3,000, and deposits A's note as collateral security, without A's knowledge. A pays to B the $5,000 he owes, but B fails to repay the Bank the $3,000 when due, B having become insolvent. What is A's liability to the bank?

2. A tells B that he wishes to give him $5,000, and hands him his negotiable note for the amount, payable six months after date. A fails to pay the note when due. State whether or not B can recover the amount. If B had endorsed it and had it discounted before maturity at the X National Bank, could the bank have recovered the amount of A, after non-payment at maturity? Give reasons.

3. A, a merchant, gives B a deed of trust on his fixtures to secure a debt of $5,000, on January 1, 1911. On July 1, 1911, A makes an assignment of his stock of goods and fixtures to C, trustee, for the benefit of his creditors. A's liabilities aggregate $20,000, exclusive of B's debt, while his stock inventories $10,000 and his fixtures $3,000. C sells the stock and fixtures at 60 per cent of inventory; and, after paying all costs and expenses, the sum of $7,000 is left for distribution. What amount is payable to B and what to the other creditors?

4. How and under what circumstances may a wholesale merchant stop a shipment of goods sold to a retail merchant before delivery thereof to the purchaser, so as to prevent such delivery? What is the legal term used to designate such action?

5. A is a dealer in wheat, of which he has several grades. B calls and inspects his stock, and, deciding to buy all of the X grade at a designated price, pays A $5,000, the price ascertained by measuring, but says he will move it the next day. C calls and leaves an order for 1,000 bushels of Y grade wheat at $1.00 per bushel, to be delivered in ten days, and deposits $500 on his contract. A has 3,000 bushels of that grade in bulk. That afternoon D, a creditor to whom A owes $10,000, levies an execution on all the wheat in A's possession, which inventories only $9,000. What are the rights of B, C, and D, respectively?

6. The firm of A & Company (composed of A and B) is engaged in the lumber business. Without B's knowledge A buys, through a broker, American Tobacco Company stock, signing the firm's name to the contract. The stock declines and is sold at a loss. To what extent, if any, is the firm liable for that loss, and to what extent, if any, is B liable?

7. B holds A's negotiable note for $5,000, dated January 1, 1905, and due January 1, 1906. It is not paid at maturity, and on July 1, 1910, B brings suit on the note. State whether or not recovery is barred by the statute of limitations.

8. B holds A's negotiable note for $5,000, dated January 1, 1905, due January 1, 1906. Failing to pay the note at maturity, A makes a partial payment of $2,000 on March 1, 1911, and says to B: "I owe the balance and will pay it in sixty days." State whether or not the statute of limitations would bar a recovery in a suit brought by B on the note on May 1, 1911.

9. Distinguish briefly between the legal form and effect of powers of attorney in the cases following, respectively:

1. To an agent to sell and convey a tract of land. 2. To an agent to conduct a mercantile business.

10. Distinguish between the following stocks issued by a corporation and state their order of preference, if any, in respect of periodical dividends; and, in case of liquidation, their order of preference in payment:

1. Cumulative preferred stock. 2. Non-cumulative preferred stock. 3. Common stock.

11. A corporation is to be voluntarily dissolved. Describe the necessary steps to accomplish this, without reference to its creditors:

1. By action of the stockholders in annual meeting. 2. By action of the stockholders in called meeting. 3. Without a meeting of stockholders.

12. Under the Virginia law, how many incorporators are required to apply for charters for the following classes of corporations, respectively:

1. Manufacturing and commercial corporations. 2. Telegraph and telephone corporations. 3. Railroad corporations. 4. Corporations requiring no capital stock.

13. A, B, and C wish to organize a corporation to have a paid-in capital of $100,000, for the purpose of developing and operating a water power for furnishing electricity for lighting and power. A owns the water power site, worth $30,000, in exchange for which he wishes stock of that amount; B, an engineer, has investigated and tested the power and is to superintend the construction of the plant, for all of which services A and C are willing for him to receive stock at a valuation of $20,000; while C is to pay cash for $50,000 of stock at par value.

Describe how this may be done, if at all, and what, if anything, is to be reported to the State Corporation Commission.

14. Name three of the classes of contracts which, under the statute of frauds, cannot be enforced unless in writing.

15. A, the owner of an apartment house, dies intestate, July 10, 1911, leaving no widow, but a minor child and two minor grandchildren, children of a deceased son, and leaving enough personal property to pay his debts. Rents aggregating $1,000 were due by tenants at the time of his death, and rents aggregating $300 per month fell due thereafter. To whom does the apartment house descend and in what proportions? What rents, if any, is A's administrator entitled to collect; and, if he should not collect any part of the rents, who should do so?

PART ONE

Theory of Accounts.

THE FOLLOWING answers refer to the questions in Theory of Accounts at the Virginia C. P. A. examination in October, 1911, and as the complete list is presented on the preceding pages it is not necessary to repeat the questions here, but a reference to them in studying these answers will be beneficial.

1. Disposition of Interest on Money Borrowed.

(a) Money borrowed to build additions to plant pertains entirely to capital, and the interest paid on said loans is considered a production expense and chargeable to manufacturing account as an item in the cost of production. It is true that many accountants regard such interest a charge against current earnings, yet we must not lose sight of the fact that the building is erected for manufacturing purposes and will in turn be charged off as a manufacturing cost in the form of depreciation; consequently it seems just as reasonable to charge to manufacturing the other direct costs connected therewith. Rent of a leased factory would be entered as a manufacturing cost, therefore interest on the plant investment is analogous and equally entitled to the same treatment.

(b) Interest on money borrowed to pay current bills may be considered a general expense or part of the administration charges, and therefore chargeable to profit and loss account. It might even be construed as a selling charge, the same as cash discounts to customers, and consequently chargeable to the trading account, but there is not much to commend such disposition.

2. Effect on Statement of Operation and General Balance Sheet.

(a) In the above case interest has been added as part of the production cost, thus giving the finished article a higher production value. It is thereby entered as a direct factory charge instead of merely a part of the general overhead expense. In any case the total cost of a given article will eventually be the same, whether interest on plant investment is charged as a manufacturing expense or a general expense, except that in the latter case it would be entered as a final charge and not as a direct expense. The statement of operation will not be materially changed by the handling of interest one way or the other as it lessens the profit on the article produced in either case. The balance sheet would likewise be unaffected by the disposition of interest as above outlined, except in cases where the goods were either unsold or undelivered. If interest is considered a production cost the article will be inventoried at a higher production value than if it were a selling or administration expense.

(b) This interest on money borrow for temporary use is clearly part of the selling expense, and therefore is logically a reduction of profits. It lessens the net profit from sales and has a corresponding effect on the balance sheet in reducing the available or working capital.

3. Difference Between Income and Receipts.

Income has reference to the earnings or revenue of a business for a given period without regard to its manner of payment, whether in cash or other property or whether still owing and payable at some future time. It is synonymous with profits and represents the gains from trading, etc.

Receipts has reference entirely to cash received during the course of business regardless of whether it is capital, revenue or exchange.

4. Difference Between Expenses and Disbursements.

Expenses include all expenditures incident to running the business, regardless of whether they have been paid or are yet outstanding. The term in this case is used in contra-distinction to income.

Disbursements indicate cash payments exclusively, though it is true that they may be all or partly for the settlement of expenses. It matters not for what purpose they are given, the intent is the same.

5. Arrangement and Classification of Accounts.

(a) CONDENSED BALANCE SHEET

ASSETS

Current Assets:

Cash Plant No. 1
Cash Plant No. 2
Cash Plant No. 3
Cash New York Office
Advances to Employes

Notes Receivable

Customers' Accounts Receivable
Funds advanced for traveling expenses
Interest paid in advance
Insurance Premiums Unearned

Investments

Sinking Fund Invested
A. C. L. R. R. Co. Bonds
N. & W. R. R. Co. Bonds
Lumbermen's Marine Insurance Co Stock
Treasury Bonds E. and F. Co. unsold

Fixed Properties:

Mills and Equipment, Plant No. 1
Additions to above
Real Estate, Plant No. 1
Additions to above
Real Estate, Buildings and Equipment, Plant No. 2

LIABILITIES

Current Liabilities:

Freight Unpaid
Payrolls Due and Unpaid
Notes Payable, secured
Accounts Payable, secured
Notes Payable
Accounts Payable
Dividends Unpaid

Fixed Liabilities:

First Mortgage Bonds
Depreciation Reserve Account

Capital, Surplus, etc.:

Capital Stock E. and F. Corporation
Surplus
Undivided Profits
Current Profits

Real Estate, Plant No. 3
Sawmill and Dry Kilns, Plant No. 3
Wharves and Warehouses, Plant No. 3
Box and Veneer Plant No. 1
Electric Plant, Plant No. 1

Timber Stock, etc.:

Timber Lands and Stumpage
Logs, Boxes and Veneer, Plant No. 1
Boxes, Lumber, etc., Plant No. 2
Lumber and Logs, Plant No. 3
Teams and Carts
Furniture and Fixtures, New York Office
Furniture and Fixtures, Plant No. 1
Store and Office Fixtures, Plant No. 2

(b) The above accounts are arranged in the balance sheet in a definite order, the same order being followed on both sides.

The assets are arranged in their order of availability in case of need in the regular order of business begining with the assets most quickly available and ending with those the least.

The liabilities are similarly arranged, begining with the current liabilities consisting of those requiring liquidation first, and ending with the fixed or those likely to be last in payment.

It is true that some of the items shown above may be arranged in different places without in any way affecting the exhibit or the end desired, but in this arrangement a common classification is shown without splitting hairs over details. The opposite order is used by many accountants, beginning with the fixed and ending with the current, but in any case it is most desirable to have like items grouped together in the balance sheet.

In answering this question the assets pertaining to the different plants could have been grouped under their respective headings, instead of being separated as shown above, but under that plan total assets of any particular kind could not be readily determined. Indeed the question asks for a condensed balance sheet, but to do this would require that all assets of one kind be given in one amount. For instance all cash at home office and the different plants would be shown in one amount, with a similar arrangement for Real Estate and other assets.

(c) The current or quick assets are those that are either available in the form of cash or can be readily converted into cash within a reasonable time, and are available for the payment of debts. If current assets are hypothecated as security for loans they cease for the time being to be quick or available.

6. Significance of Debit and Credit Items.

(a) There are four main classes of accounts, so that an entry of any kind will affect either of these classes. An amount placed on the debit side of a ledger account, then, represents according to the class it belongs to:

An asset, thereby increasing the assets.

An expense, thereby increasing the losses with a corresponding decrease in the net profits.

A production charge, thereby increasing the cost of producing a given article.

A cancellation, being the settlement or cancellation of some liability. An entry of this kind has only a neutralizing effect without causing any corresponding change in the capital or profits.

(b) An entry placed on the credit side of a ledger account represents, according to the class it belongs to:

A liability, thereby increasing the liabilities.

A revenue, thereby increasing the income or earnings of the business with a corresponding increase in the profits. Any increase in profits produces, of course, a like increase of the capital.

A cancellation, being the settlement of, or cancellation of some asset in the form of notes or accounts receivable. It may represent the disposal of some asset, and in case any profit is occasioned in connection therewith it is evident that both classes of accounts become affected.

7. Entries for Bills Receivable Discounted.

Notes under discount at the bank are always indorsed by the payee and he is liable on them until paid by the maker. This is known as a contingent liability, and in the present case where it amounts to $27,000, some plan should be adopted whereby details thereof will be constantly before the person liable thereon. In most cases they are shown only as a part of the regular report or as a foot-note to the monthly or yearly balance sheet, but in many others the following plan is used:

(1) When the note is received the usual entry is made,		
Notes Receivable	$1000.00	
To Customer		$1000.00
(2) When discounted at the bank this entry,		
Cash	990.00	
Discount	10.00	
To Notes Discounted		1000.00
(a) When paid by the maker at maturity,		
Notes Discounted	1000.00	
To Notes Receivable		1000.00
(b) When paid part cash and part by new note,		
(1) Notes Discounted	1000.00	
To Notes Receivable		1000.00
(2) Customer	500.00	
To Cash		500.00
(3) Notes Receivable	500.00	
To Customer		500.00
(c) Protested at maturity for non-payment, fees added,		
(1) Customer	1001.50	
To Cash		1001.50
(2) Notes Discounted	1000.00	
To Notes Receivable		1000.00

(d) Taken up with new note at maturity with interest added,

(1)	Customer	1000.00	
	To Cash		1000.00
(2)	Notes Discounted	1000.00	
	To Notes Receivable		1000.00
(3)	Notes Receivable	1010.00	
	To Customer		1000.00
	To Interest		10.00

On this plan the notes discounted account will exhibit at any time the liability on discounted notes, and the due date of each should be shown therein. In the above entries the renewal notes are not discounted yet, but when they are the usual process will be followed. The balance sheet may show aggregate notes receivable among the assets, and notes discounted as a deduction from the notes receivable. Since the above plan requires so many journal entries it may be advisable to provide columns in the notes receivable book for exhibiting the notes under discount and all other information pertaining to them.

8. Books Necessary for a Corporation.

(a) State incorporation laws are usually conspicuous for their silence in the matter of books of record, and the State of Virginia is no exception to the rule. A transfer book is required, however, and a register of stockholders' names and addresses. By-laws and stock certificates are also a necessity, and the minute book is a prerequisite. New York requires correct books of account for all its business transactions; a stock book containing names and addresses of stockholders with shares held, when they become owners thereof, and amount paid thereon; a transfer book to accompany the stock book. By-laws and stock certificates are specified also. The stock book shall be open daily during at least three hours for the inspection of stockholders and judgment creditors, who may take extracts therefrom.

Pennsylvania requires that "the secretary or clerk is charged with keeping a record of notes of the corporation and minutes of its transactions." New Jersey requires transfer book in which the transfer of stock shall be registered, stock books with names, etc., of stockholders, record of all minutes of stockholders and directors.

Of course every corporation requires its books of account the same as an individual trader or firm, but in addition to these the following are known as the books of record, including the official documents: Articles of incorporation, subscription blanks, by-laws, minute books, stock certificate book, stock record, transfer book, transfer certificates, register of directors, dividend record, etc.

(b) The books of record are of value to the auditor in determining the powers and obligations of the corporation and in satisfying himself that the directors have acted in accordance therewith and as required by the company's by-laws.

The stock record and transfer books, and the stock certificate book will show the amount of stock outstanding, which should agree with the capital stock account.

The charter and by-laws are required in determining the requirements of the stockholders, with which the directors must comply in every particular.

The minute book is of importance in showing the acts of the stockholders and directors, as it contains the official requirements of these two bodies, all of which must be observed by the officers and employes.

The transfer book and certificates of transfer show the various transfers and the authority for making them.

9. Reserves and Depreciation Accounts.

(a) The depreciation account, known also as reserve for depreciation, is opened in order to show from year to year the amounts reserved or appropriated from profits for depreciation of fixed properties. Instead of actually writing down or reducing the book value of the property by crediting it with the amount written off, it is carried on the books at its cost value and the amount of depreciation credited to a negative account, the depreciation reserve account. This is accomplished by a charge against profit and loss account, or manufacturing account. When the property so provided for is replaced or becomes obsolete, the cost value of same is charged to the depreciation reserve account.

Some accountants open a depreciation account and charge it monthly with the allowance for depreciation written off the various properties, with a corresponding credit to depreciation reserve account, or to the property itself if it is being written down. In this case the depreciation account shows a debit balance and in turn would be charged against the profit and loss account or the manufacturing account as the case may be. Repair and maintenance charges on machinery, fixtures, buildings, etc., are also now considered a proper charge against these reserve accounts, if so provided for, thereby allowing the figuring of actual costs more closely and keeping them in greater uniformity.

(b) Following are the accounts and entries needed to provide for depreciation reserves:

(1) Machinery account	$50,000.00	
To Cash		$50,000.00
(2) Profit and Loss, or Manufacturing Account	5,000.00	
To Depreciation Reserve		5,000.00

10. Treatment of Goodwill.

Goodwill usually represents the cost of a business taken as a going concern over and above the actual value of its capital. In other words, it is an estimated value placed upon its earning capacity or upon the good name, trade or custom which it enjoys. It may be represented by its earning capacity, its business standing, its location, its ownership of patents, trademarks, contracts, etc., but the continuance of said goodwill as an asset depends upon the future conduct of the business and the ability of the new management to hold the patronage already secured.

11. Factors of Manufacturing Cost.

(a) Prime Cost, which includes:
Material used, at total cost of same. Direct labor, of workmen actually engaged in the product.

(b) Factory or Overhead Expenses, including:
Indirect labor, of foremen, helpers, etc. General factory expenses, as heat, light, power, etc. Factory supplies, etc. Depreciation of equipment, etc. Salaries to factory management, etc.

12. Items of Selling Cost.

Selling expenses, salaries, advertising, etc. Administrative expenses, salaries, etc. Fixed charges, rent, taxes, insurance, etc. Depreciation and bad debts. Deductions from sales, allowances, discounts, etc.

13. Fixed or Overhead Expenses.

All the expenses of a factory not directly chargeable to the particular jobs in process, and which must be prorated to the various jobs according to some approved method of distribution. They include all of the indirect general and administrative expenses of the entire factory up to the completion and delivery of the product from the factory to the warerooms.

This includes indirect labor, general factory expenses, supplies, repairs and renewals, salaries of managers, superintendents and clerks in the factory, depreciation, etc.

There is also a general overhead which has no place in the manufacturing. It includes the various expenses incident to the business and sale of goods after they leave the factory.

14. The Nature of a Balance Sheet.

A balance sheet is a statement of the assets, liabilities and capital of a business at any particular time. It is presumed to reflect the financial condition of the concern as shown on a set of double entry books. It takes the name from the "balance account" formerly used to contain all of the balances of the closed ledger accounts. At the time of closing the ledger all real accounts were closed into the balance account. The assets are shown on the Dr. or left-hand side, while the liabilities and capital are shown on the Cr. or right-hand side. This form is often changed slightly by using a single page only in which the assets appear at the top, followed by the liabilities and capital.

15. Difference Between Balance Sheet and Statement.

A statement of assets and liabilities is known also as a balance sheet, since they both present the same information, the financial condition of the business, but a statement may contain items taken either from a set of double entry books or from various other sources. Since it is frequently necessary to compile the assets and liabilities from various sources other than from the ledger, it is obvious that the term "Balance Sheet" would be a misnomer, except for a statement which showed the items listed to be in balance.

THEORY OF ACCOUNTS (Continued).

THE FOLLOWING questions are from recent examinations in New York, Pennsylvania and Illinois and are fairly representative of the class of questions in Theory of Accounts usually made use of:

No. 1—A corporation manufacturing explosives is compelled to pay exorbitant rates for a very limited amount of insurance, and in consequence was obliged to install an automatic sprinkler system at a cost of $75,000. This additional fire protection enabled them to secure a full line of insurance, though in mutual companies, and at a much lower rate than was obtainable prior to such installation. At the end of the fiscal year the company received dividends from these mutual insurance companies, aggregating $2,000. To what account should the cost of the sprinkler system be charged and to what account should this dividend be credited? State your reasons fully.

No. 2—Describe the statements that you should prepare to disclose the financial transactions of a fraternal organization for an accounting period of one year, and its condition at the end of such period.

No. 3—In the annual report of a Life Insurance Company what does a reserve mean, how is it arrived at, and how does it affect the results of the business?

No. 4—Describe shortly how you would make up the trading account of a business where there were no regular books of account, and in respect to which you were able to obtain only the Bank Book, Check Book stubs, Petty Cash Book, unpaid accounts, a Memo Ledger of Customers and a rough Journal.

No. 5—In a city where taxes are payable on May 1st, based on assessments made January 1st, and are used to provide for expenditures made by the city in the previous year ending December 31st, what liability should be set up at March 31st by a company closing its books at that date and knowing that the tax to be paid on May 1st would be $1,200? Give reasons for the principle you follow.

No. 6—An old established and highly prosperous business is transferred in 1900 to a company which pays the proprietors $300,000 for all fixed assets and $50,000 for good will. In 1909 the company has accumulated $125,000 of undivided profits, and the directors decide to charge off the entire item of good will. What effect will this have upon the accounts?

No. 7—It has been stated "that the right to declare a dividend depends upon the state of the company's finances at the time when the dividend is declared." Give your opinion briefly as to conditions under which a company may borrow money for the purpose of paying a dividend.

No. 8—You are retained by an industrial company to make such an examination of its accounts as will enable you to certify to its balance sheet at Dec. 31, 1908, the object of the company being to aid it in selling its notes through note brokers.

THEORY OF ACCOUNTS

Give an outline of your method of procedure, showing the extent to which you would consider it necessary to carry your examination in respect to the several classes of assets and liabilities.

Assuming that you are satisfied to give a certificate to the balance sheet, in what form would you express it?

Answers.

No. 1—Insurance premium is an expense which must be maintained if business operations are to be conducted without assuming the risk of loss by fire. It is proper to reduce expenses if possible, and in this case a reduction has been made, though the initial outlay in providing adequate fire protection has of necessity been large. After considering the depreciation of the automatic sprinkler system and interest on the investment in same, if the cost of greater fire protection is less than heretofore, then a corresponding increase in net profits has been made. When the sprinkler system is purchased, charge the cost of same to Automatic Sprinkler System account or to Equipment account. The insurance premiums may be charged to Insurance Premium account and the dividends received credited to the same account. Charge depreciation of sprinkler equipment to this account also, and, if deemed advisable, interest on the $75,000 invested therein. The balance of the insurance premium account, less prepaid premiums, shows the nėt cost of insuring the property, and should be charged to the manufacturing account. In mutual fire insurance companies the people insured are the ones who benefit by profits earned. Premiums are paid regularly to the company, but at the end of each year the profits earned, less fire losses, expenses and surplus, are distributed among the various policy holders either in cash or by a reduction from the next premium payment, or by an issue of dividend scrip. It will be seen that this plan is practically a self insurance undertaking in which the people insured contribute the funds which pay fire losses, and then benefit by surplus profits. Automatic sprinkler systems are usually placed in manufacturing establishments and stores where combustible matter is kept, and the water pressure is generally supplied from a tank on the roof of the building or apart from it. When a fire occurs in any part of the building the heat melts the caps on the pipes and permits the water to flood the room.

No. 2—The affairs of a fraternal organization must be conducted in accordance with the laws under which it was incorporated, the charter privileges and the by-laws of the organization itself. In preparing the statements the accountant should satisfy himself that all requirements have been fulfilled.

Fraternal organizations are usually on a cash basis, therefore the cash book is the main book and records all receipts from whatever source, as well as all disbursements for expenses, investments, benefits, death claims, etc.

A stateemnt of income and expenses should be prepared, setting forth the entire income for the year and apportioned to the various purposes for which received, as Insurance, Benefits, Fines, Assessments, Interest,

Dividends, etc. This should include dues in arrears, accrued interest on investments, etc.

Care must be taken to see that income from the various sources is apportioned to the proper funds and accounts for which received.

The expenses will include among the usual accounts, outlay for sick and funeral benefits, death claims, traveling expenses, agents' expenses, general expenses, taxes, reserves, etc.

The above comments have reference more particularly to the head office of the organization, which indeed would require an exhaustive examination if the affairs are to be clearly set forth. In the case of a local lodge the transactions are very simple and require much less time. All financial transactions are handled by the secretary and the treasurer. All moneys are received by the secretary and turned over to the treasurer, and his receipt take for same. Payments are made by the treasurer upon orders from the secretary after approval by the lodge. The secretary is the principal officer, and is responsible for the collection of funds, keeping of accounts with members, issuing orders on the treasurer for payments, etc. The treasurer keeps the bank account, makes all deposits, issues checks upon duly authorized orders, and is responsible for the safe keeping of the funds.

The usual annual statements are:

1. The Treasurer's Report, showing the receipts and disbursements of cash and for what purposes, the cash and investments on hand, etc.

2. Secretary's Report, showing the cash received and turned over to the treasurer, and the payments per orders issued on the treasurer.

3. The Secretary gives a further report as to membership, setting forth:

Membership at begining of year.
New members during year.
Reinstatements during year.
Withdrawals, transfers and expulsions.
Members in arrears, etc.
Statistical report as to deaths, sickness, benefits, etc.
Comparative statement for term of years.

The financial condition at the end of the year should be set forth in a statement of assets and liabilities, showing the property owned, cash and investments, dues in arrears, etc., and the liabilities, if any, the general fund, sick fund, etc.

No. 3—Insurance Reserve. The reserve is the amount required by law for an insurance company to have on hand in substantial assets to enable the company to carry out its contracts with policy holders. Since the company enters into contracts whereby it agrees to pay to the insured definite amounts at death or at certain times, as at the end of say ten or twenty years, it is evident that it must set aside for each obligation such amounts as will equal said obligation when it matures. The annuities set aside draw interest and are usually invested in good securities. The law

requires that the reserves shall be figured at conservative rates, either 3 or 3½% according to actuaries' mortality tables, and the lower the rate the greater the amount to be reserved each year. Death claims according to the mortality tables, average so many per year to the thousand, therefore the company must so arrange its income and reserves as to pay these claims and still provide for expenses, dividends and surplus profits.

New obligations are constantly being entered into and a continuous flow of premium money being received, so it is impossible at any one time to say how much the reserve amounts to. The burden of keeping the reserve in condition devolves upon the actuarial department, and in estimating correct amounts every policy issued must be considered and averaged. They estimate that such a portion of the annual premium on each policy must be set aside as will be required to accumulate the face value of the policy at the estimated due date. Reserves as such are non-ledger accounts, that is, they do not appear as such in the ledger, but are so recorded in the anual statements to the various states in which they transact business.

No. 4—From the data given we can easily determine the purchases and sales. It is then necessary to prove cash and reconcile the bank account, after which an inventory should be taken of all goods on hand.

The receipts and payments of cash should be verified and analyzed, as far as possible. The payments can be determined from the check stubs and petty cash book. All cash payments plus cash on hand must equal the total cash received; or the total deposits plus petty cash payments must equal the cash received, in case petty cash payments were made out of cash received. If petty cash had been drawn from the bank on the Imprest plan then the presumption is that all receipts were deposited, in which case the total deposits would equal the total receipts.

From the total cash received deduct the original balance or investment, and the remaining receipts may be considered as from sales of merchandise. The sales thus shown plus accounts of customers constitute the entire sales for the year.

Since the cash payments for goods purchased can be determined from the records, add to these the unpaid accounts to get the aggregate purchases.

The above analysis is based on the assumption that the firm is in its first year of business, otherwise it would be necessary to determine the goods on hand, the accounts receivable, and the accounts payable at the begining of the year. From the information already compiled and the data recorded in the journal the accountant would not experience much difficulty in setting up a satisfactory Trading Account.

No. 5—This question has reference to the provision for accrued taxes on the company's books. The fiscal year of the city ends on Dec. 31, at which time the amount needed for taxes is fixed and nominally due, while the company under consideration ends its fiscal year March 31st. It is evident that on this date the company would not only set up a liability for

the tax levy of $1,200.00 due on May 1st for the past calendar year, but should make allowance for accrued taxes for the three months of the present year based on the previous year's tax levy. On this basis the amount of provision should be $1,500.00 by a charge to profit and loss account and a credit to taxes account. When the $1,200.00 is paid on May 1st, the accrued item of $300.00 will remain as a credit to the taxes account until the next date of adjustment. In succeeding years only the fixed amount to be paid (say $1,200.00) need be added at the closing date, since a balance to taxes account will have to be carried over from the previous year; and any fluctuations in taxation can be easily adjusted when closing the books.

No. 6—Good will charged against surplus. It is perfectly proper for the directors of a company to write off good will against surplus profits if they deem it advisable to do so. In this case the surplus is sufficiently large to justify this procedure and still leave a balance of $75,000 of undivided profit. From the progress of the company, however, judging from the surplus profits set aside, there is no necessity of writing off the good will, since the company is in good condition and prosperous. Under such a condition the good will might even be estimated at a higher figure if circumstances required a re-valuation.

The book accounts of the company will not be affected by this action of the directors other than to decrease the assets $50,000, and to make a corresponding decrease in the surplus account. Since the good will is a passive asset and not at all necessary for a going concern, it can be eliminated without affecting in any way the standing of the company or the status of the accounts. By so doing, however, good will as an asset is eliminated and a substantial secret reserve created. It is true that the stock of the company may appear to be of less value by a decrease of surplus, but such a conclusion is unfounded because of the reserve strength of the company, and the substantial profits which are being made.

No. 7—The directors of a company have the right to declare dividends in case the company is in a condition to do so, providing that by so doing the capital is not impaired. While it is not advisable to declare dividends up to the last dollar, yet in many cases the directors feel called upon to overstep the bounds of conservatism in order to maintain the standing of the company, and in order to pay dividends they may either have to draw heavily upon surplus profits or to create fictitious profits for that purpose. When dividends have been declared, however, they become a liability of the company and a claim by the stockholders, therefore the stockholders may demand payment. This liability of a company must be paid even if in order to do so the company has to borrow money. It is better not to declare dividends when the company is in such close circumstances, but everything else being equal, it is not improper for the directors to do so. If the company is short of cash with which to pay dividends because of being heavily stocked with merchandise or other assets, a temporary loan may be resorted to, or even promissory notes may be given to the stockholders for all or part of the dividends due.

No. 8—When a business concern has reached its limit of credit with its banker, it often sells its notes to other banks, including country banks, through note brokers. The broker places the notes of his customer if possible, and receives for his services a commission of 1/8 or 1/4 of one per cent. In order to secure the accommodation of banks in this way the maker of the notes must be able to show that he is financially responsible and able to meet his obligations at maturity.

In this question the company must show that it is entitled to credit, and to do so its balance sheet has been presented as evidence, and the attached certificate of the certified public accountant is conclusive evidence of its genuineness. Before giving his certificate, the accountant must satisfy himself that all assets are genuine and not overstated, and that all liabilities are listed and truly set forth. He is concerned only with facts as he finds them and must so report them, because on the strength of his certificate credit will be granted or refused. He should examine the Profit and Loss account for the past year to satisfy himself that the profits have not been overstated for the purpose of making a good showing. If he finds anything requiring adjustment it should be satisfactorily adjusted before he attaches his certificate.

It is necessary to audit the receipts and payments of cash, and to verify the present cash balance by counting the cash and reconciling bank account. The current assets should be examined carefully to see that they are conservatively valued and actually available. The accounts receiveable should be listed under good, doubtful, approbation, consignment, etc., and all worthless items excluded. Overdue notes should be shown separately and a reserve for doubtful notes and accounts provided. If sales have been made for future delivery and the accounts charged, the goods thus disposed of should not be included in the inventory; such accounts should be listed separately in the balance sheet. The fixed assets should be examined and the incumbrances against them carefully noted. Passive assets, as good will and accrued items, should be shown separately.

The liabilities should have close attention to see that they are all included, and the accountant must not take anything for granted in his examination. Notes, accounts and other obligations should be separately listed, and the dates when due clearly indicated. Contingent liabilities should be listed and shown on the statement. The accountant's certificate may be as follows:

Certificate—This certifies that I have examined the above Balance Sheet, and have compared the items therein with the books of the company. The various assets and liabilities have been carefully investigated and verified, and in my judgment present a true and correct view of the company's affairs.

(Signed) R. J. BENNETT,
Certified Public Accountant.

THEORY OF ACCOUNTS (Continued).

Miscellaneous Questions.

THE FOLLOWING questions have been selected because of their generality and also because of the difference of opinion which sometimes exists in connection with the subjects covered.

Question 1.

Contrast the daybook, journal and ledger method of book-keeping with some more modern method. Describe the limitations of the first mentioned method and show to what extent, in what manner and for what reason it has been superseded or modified in modern accounting practice.

Answer.

The old fashioned daybook was only a memorandum book, arranged in chronological order, but without classification. The items were sorted out and then journalized; from the journal they were transferred to the ledger.

The modern daybook is constructed on the columnar principle; the ledgers likewise. The journal is discarded altogether and used only in a few instances, i. e., opening and closing entries, adjustments, etc. The modern accounting system is built on two main principles:

1. The explicit record of each transaction direct from original books of entry;

2. The ready classification of such transactions under proper headings in tabulated form. The advantages of the modern system are:

a. Plain and self-explanatory records;

b. A minute classification of such records, showing the sources and final results at a glance;

c. An enormous saving of time and labor;

d. A ready inspection of the books is afforded and statistical work made easy.

Question 2.

Define and differentiate the terms "reserve account" and "reserve fund."

Answer.

A clear distinction should be made between the terms "account" and "fund," as contrasting each other.

a. A reserve, in this sense, represents a portion of the profits of the business set aside for some specific purpose, usually as an offset to some item represented in the assets. For example, reserve for depreciation, reserve for bad debts, etc. To this account should be charged depreciation, or losses on any assets for which it has been reserved. It should always appear as a credit balance and while the amount so reserved is represented by part of the assets, though not specifically designated, such balance is not always available as a cash asset.

b. A "fund" should always appear as a debit balance and ranks as a specific cash asset. The term "fund" invariably indicates that cash is either on hand, invested or deposited for the purpose of meeting some liability or of making some improvement at a future time.

Question 3.

In what respects and for what reason do the books of account of a commission merchant differ from those kept by an importer?

Answer.

The difference in accounts between the commission and importing business lies in the principles of ownership and possession.

The commission merchant is not the owner of the goods; consequently no merchandise account exists on his books. He simply credits the consignment account. His remuneration is the commission agreed upon. The whole transaction is a question of possession solely, a bailment sale. He sells the goods, deducts his expenses and commissions and sends the net proceeds to his principal.

The importer, again, usually buys the goods through his agent abroad: here is a question of ownership.

The fluctuations in exchange form an important item in an importer's business and should receive careful consideration; also the various expenses and charges incident to the importing business.

An importer may also do a commission business; he is then on the same footing as the commission merchant in his line, and his accounting system in the commission line will be that of the commission merchant.

Question 4.

Outline entries necessary to record on the books of the consignee all the transactions incident to a consignment.

Answer.

The consignee should open two accounts on the receipt of goods, entered up in detail in the receiving book.

"Consignment from X" account is debited with the value of the goods, and "X, consignment" account is credited with the corresponding amount.

The former account is a temporary trading account, while the latter is a personal account; this temporary trading account is credited with the sales. It is charged with all expenses, such as freight, insurance, duty, labor, etc. When all goods have been sold, the result will be either a profit or a loss, which is transferred to the personal account. The difference in "X consignment" account, constitutes the net proceeds which are remitted, and the account will be closed. Advance payments on account of the consignment are of course charged to the personal account when made. The consignee will also send the consignor an "account sales" from time to time, showing the progress of the sales, less expenses incurred, for adjustment on consignor's books.

Question 5.

On what theory is the doctrine of equilibrium in book-keeping founded? Explain.

Answer.

The doctrine of equilibrium in book-keeping is based on the fundamental principle that each debit must have its corresponding credit and vice versa. Every amount is entered twice; once on the debit side and once on the credit side: a twofold entry.

A benefit is received: debit once.

A benefit is imparted: credit once.

Debit value in and credit value out are corresponding accounts.

Question 6.

What great method of expressing accounting results has been evolved out of the doctrine of equilibrium?

Answer.

Book-keeping is simply a transfer of money or money's worth. The evolution of the doctrine of equilibrium resulted in the modern double entry book-keeping, a complete scientific system of recording business transacted, with its final exposition of profit and loss account, closed into the balance sheet which will then maintain the equilibrium, thus proving the arithmetical accuracy of the final results.

Question 7.

Compare a simple arrangement of accounts, as for example, capital, cash, merchandise, personal expense, profit and loss, with some other scheme of accounts expanded to meet the demands of present day requirements. Describe the possibilities and advantages of the more modern scheme.

Answer.

The personal accounts, according to modern accounting methods, should be kept on the self-balancing plan, customers and creditors in separate ledgers, accompanied by controlling accounts, showing in toto the actual amount of the personal accounts in detail, thus making the work on trial balances easier. Errors are localized and the aggregate amount of personal accounts as shown in the trial balances determined by the controlling accounts. The controlling account in the general ledger represents the aggregate personal accounts due to the concern, and it agrees with the corresponding controlling account in the accounts receivable ledger. This is true also of controlling accounts for the accounts payable. The general ledger should contain the usual nominal accounts; the balance is closed into the private ledger, thus controlling the correctness of the book-keeper's work at balancing time.

The private ledger, under lock and key, is accessible only to the proprietors or their confidential man, thus keeping the results of the year's transactions from the knowledge of the general book-keeping staff.

The private ledger usually contains the following accounts:

Capital accounts, merchandise accounts, proprietors' drawing accounts, balance sheet and generally such accounts that the proprietors wish to keep from the eyes of the book-keepers.

This system is known under the name of the "Safeguard System." It obviously differs widely in arrangements from the old systems, still in vogue, and its utility and superiority cannot be overestimated.

Question 8.

At the close of a fiscal period how are consigned goods treated on the ledger and balance sheet of (a) the consignor, (b) the consignee?

Answer.

(a) Consignor. The balances on the various consignment accounts in the consignment ledger are either carried to the profit and loss account or are left standing in the ledger, and so appear as assets in the balance sheet. The balances which are carried to profit and loss account are the dered and duly recorded. They indicate that either a profit or a loss has been made on the venture.

The other balances in the consignment ledger will then consist of consignments unrealized at date of stock-taking, and these are taken as assets. On the balance sheet the consignment accounts should be stated at cost price, together with incurred expenses; ample reserve should be created for possible losses, and this reserve should be deducted from the consignment accounts, thus showing the estimated value at closing time.

When only part of a consignment has been sold at stock-taking and there is a part unsold, the treatment of the account greatly depends on circumstances, though sometimes the portion already disposed of is closed into profit and loss.

b. Consignee. In the consignment ledger, accounts are opened with number of consignment and consignor's name. When the consignee has power to dispose of the goods as he thinks best and sells them to one of his own customers, he makes a journal entry debiting his customer and crediting the consignor, as he is liable to the consignor for the proceeds which he will receive from his customer.

On the balance sheet, all goods on hand should not be taken into account, as such goods are not the consignee's property, but only in his custody. From his register of consignment the consignee sends the consignor a list of goods on hand for verification.

Question 9.

Define and differentiate executor, administrator, trustee.

Answer.

a. An executor is a person appointed in the will of testator or testatrix to settle his or her estate. One or more persons may be named, male or female.

b. An administrator is a person appointed by the court to settle the estate of a deceased person. If no executor was named in the will, or the appointed executor refuses to act, resigns, fails to act or dies, the court will appoint an administrator with the will annexed.

The executor derives his authority from the will, the administrator from the court. The duties of the two are substantially the same.

c. A trustee is a person entrusted with property for the benefit of another. The powers and duties of a trustee are strictly limited by the particular instrument creating the trust, whereas the executor and administrator take powers by virtue of their offices. A trustee in bankruptcy is appointed by the court, or elected by creditors, to take charge of, hold or dispose of the property and assets of a bankrupt estate.

PART TWO

Practical Accounting.

ANALYSIS OF ACCOUNTS.

THE FOLLOWING question has been selected as an interesting study in analysis rather than as a problem in Accountancy. Beginners will find it beneficial, and even more advanced students of auditing may find it worth while:

"You are asked to redraft the following statements if they are incorrect. Interest on capital is at 5 per cent per annum.

PROFIT AND LOSS ACCOUNT FOR SIX MONTHS ENDED 31ST DEC., 1912.

To Purchases	$27,000.00	By Sales	$40,025.00
Stock, 31st Dec., 1912	5,000.00	Int. on Capital	500.00
Partners' Drawings	2,500.00	Stock 1st July, '12	8,250.00
Rent	500.00	Commissions	1,500.00
Salaries	1,500.00		
Wages	4,750.00		
General Expenses	900.00		
Interest on Loan	125.00		
Bal. Net Profit	8,000.00		
	$50,275.00		$50,275.00

BALANCE SHEET, 31ST DEC., 1912.

Creditors	$ 5,400.00	Debtors	$10,200.00
Bills Receivable	3,200.00	Cash on Hand	700.00
Partners' Accts., 1st July, 1912.	10,000.00	Cash in Bank	4,000.00
Net Profit	8,000.00	Loan from Bank	5,000.00
		Stock, 31st Dec., 1912	5,000.00
		Bills Payable	1,700.00
	$26,600.00		$26,600.00

The Answer.

REDRAFTED BALANCE SHEET, DEC. 31ST, 1912.

ASSETS		LIABILITIES		
Cash on Hand	$ 700.00	Accounts Payable		$ 5,400.00
Cash in Bank	4,000.00	Loan from Bank		5,000.00
Bills Receivable	3,200.00	Bills Payable		1,700.00
Accounts Receivable	10,200.00			
Stock on Hand	5,000.00	Total Liabilities		$12,100.00
		Capital Accounts:		
Total Assets	$23,100.00	Investment	$10,000.00	
		Less Drawings	2,500.00	
			$ 7,500.00	
		Add:		
		Interest	$ 250.00	
		Net Gain	3,250.00	
		Present Capital		$11,000.00
	$23,100.00			$23,100.00

PROFIT AND LOSS ACCOUNT, REDRAFTED DEC. 31ST, 1912.

DEBITS		CREDITS	
Inventory, 7-1-12	$ 8,250.00	Sales	$40,025.00
Purchases	27,000.00		
Wages	4,750.00		
	$40,000.00		
Deduct:			
Inventory, 12-31-12	5,000.00		
Cost of Sales	$35,000.00		
Gross Gain, carried down	5,025.00		
	$40,025.00		$40,025.00
Rent	$ 500.00	Gross Gain	$ 5,025.00
Salaries	1,500.00	Commissions	1,500.00
General Expenses	900.00		
Interest on Loan	125.00		
Total Charges	$ 3,025.00		
Interest on Capital	250.00		
Net Gain	3,250.00		
	$ 6,525.00		$ 6,525.00

Comments.

This question is not difficult, but it contains some points of interest and the reader will be repaid by making a study of it before consulting the answer. The items are mixed up more than one would expect to find in statements, and the fact that both of them balance by an apparent net profit of $8,000.00 would lead one to suppose that this had something to do with the final result. It has nothing whatever to do with the solution and it is quite interesting to note that balances could be secured in such a condition of affairs.

The business has been running for six months. Interest on capital for six months amounts to $250.00 instead of $500.00 as shown in the statement. From the figures a statement of assets and liabilities can be easily compiled, the balance of which gives the present capital of the firm, $11,000.00. It will be noted that the investments were $10,000.00, while the withdrawals were $2,500.00, leaving a net investment of $7,500.00. To this amount add interest on original investment, $250.00, giving a total of $7,750.00. The difference between this amount and the capital, $11,000.00, is the net profit for the period, $3,250.00. If interest on capital is considered a profit then the net gain is $3,500.00. In solving the problem the first step is to determine the net capital, and then the net gain, after which the matter of preparing the profit and loss statement is very simple. Commissions amounting to $1,500.00 are evidently earned, though there is nothing in the question to signify this conclusion other than by the balance obtained. We must, however, secure a net gain of $3,250.00, and to get this amount the items of the statement must be arranged in such a way as to produce the required result. No accrued interest or depreciation has been considered, but it would be prudent to provide for such.

ANNUITIES AND SINKING FUNDS.

The following questions on Annuities and Sinking Funds are selected to illustrate the manner of using compound interest in actual practice:

1. A railroad company issued Sinking Fund Bonds at 5 per cent for $5,000,000, payable in twenty years, interest coupons payable semi-annually. What amount must be set aside at the end of each year and compounded at 4 per cent to meet the principal when due?

Make the entries involved in the transaction up to and including the end of the second year.

2. A town borrowed $40,000 for street improvements, to be repaid in fifteen years by equal annual installments including principal and interest. If the rate of interest is 5 per cent, what is the amount of the annual payment? Show the respective amounts paid for principal and interest during the first two years.

Show the bookkeeping entries necessary during these two years.

3. A county borrowed $25,000 with which to build a bridge, and raised $2,000 a year to pay for it. Allowing 5 per cent compound interest, how many years will be required to cancel the debt?

General Comments.

Bonds of different kinds and tenor are issued by corporations, municipalities, states, and the Federal Government, and the work of the accountant brings him in contact with them all. The bonds themselves present very little difficulty to the average practitioner, but the matter of providing for their redemption and the calculations required in connection therewith are not so well understood. It is true that the calculations may be eliminated almost entirely and the required amounts obtained from the annuity tables, but notwithstanding this convenience every competent accountant should be familiar with the methods of calculating annuities and arriving at correct results. In order to understand calculations in annuities, sinking funds, etc., it is necessary to have a thorough knowledge of compound interest as the principles underlying it govern all questions of this sort. The person desirous of mastering this subject should first review with care simple and compound interest, present worth and true discount, progression, powers and roots. If he has a knowledge of logarithms so much the better, but for practical purposes this is not a necessity.

An annuity is a payment of a definite sum of money annually or at regularly recurring intervals, not necessarily annually, but usually so. If we consider what causes an investment of $1 at 5 per cent per annum to amount to $1.21551 in four years, we shall see that it is a regular annual addition of 5 cents to the original $1—in other words, the addition of an annuity of 5 cents which in its turn increases at the rate of 5 per cent per annum. Suppose the original $1 to have been left in the Citizens' Bank for the entire period of four years and only the annual interest of five cents withdrawn as soon as it came due and deposited at the same rate

per cent in the Central Savings Bank. It is clear that at the end of four years we shall have just $1 in the Citizens' Bank and $.21551 in the Central Savings Bank. The amount in the last named bank is simply the result of an annuity of 5 cents per annum paid into it for a period of four years; therefore, $.21551 is the value at maturity; that is, the final value of an annuity of 5 cents for 4 years at 5 per cent. From this, the final value of an annuity of $1 or any other sum may readily be found. For if an annuity of 5 cents has a final value of $.21551 then an annuity of $1.00 has a final value of 20 × $.21551 = $4.3102. The process may be stated in the following rule: To find the final value of an annuity of $1 for a given time at a given rate, first find the compound interest on $1 (from the compound interest tables in any good arithmetic, or by calculation) for the given time at the given rate, then multiply by 100 and divide by the given rate.

Answer to Question No. 1.

As nothing is mentioned in the question about underwriting expenses, commissions, or discounts, we may pass by the consideration of those points and suppose the bonds to have been sold at par. The interest coupons are payable semi-annually and do not affect the annuity payments in any way. As they mature they are paid and the amount charged to Bond Interest which, in turn, is closed into Profit and Loss account. In twenty years the railroad company must pay $5,000,000, and during that time must set aside at the end of each year a definite sum to remain at compound interest until the maturity of the bonds. It will be readily seen that the first installment to the sinking fund will be at interest for 19 years at 4 per cent, the second for 18 years, the third for 17 years, and so on, until the last installment is made, which will be at the date the bonds mature and therefore will not draw any interest. The required annual installment is found to be $167,908.75, and is determined by dividing into $5,000,000 the final value of an annuity of $1 for 20 years at 4 per cent. This final value is $29.778079 as shown by the annuity tables, or as determined by the method suggested at the beginning of this article. This amount may be determined also by adding together the final values of an instalment of $1 at compound interest for all of the years from 19 down to 1 and including the last payment or deposit of $1 which does not draw any interest. This can be readily determined from the compound interest tables. It will be seen that the ordinary compound interest tables, which are familiar to every school boy, can be used in computing many of the annuity problems which baffle many accountancy students and prove stumbling blocks to accountants.

Referring to the question, the final value of an annuity of $1 at 4 per cent for twenty years must first be found as follows:

$1.04^{20} = \$2.19112314$. Now take the compound interest,

$$\frac{\$1.19112314 \times 100}{4} = \$29.778079, \text{ the final value of \$1 annuity.}$$

Now if $29.778079 is the final value of an annuity of $1, then $5,000,000 is the final value of $5,000,000 ÷ $29.778079 = $167,908.75, the required

sinking fund. It is self-evident that the sinking fund installments must be regularly deposited and continued at the rate of 4 per cent to provide the estimated amount.

The Book Entries.

When bonds are issued by corporations there is usually some method adopted for their redemption when due, providing they are not liquidated by annual installments of interest and part of the principal. The sinking fund method is a common one, and the annual appropriations are usually put into the hands of a trustee for investment and safe keeping. The appropriation to be so deposited may be the amount as computed above, or else a definite sum of, say, one-twentieth of the total debt, $250,000, the interest on which would be paid over to the company at regular interest periods. This method is a convenient one and removes from the matter any consideration of compound interest on the annual installments. The sinking fund installments are usually taken out of profits as a precaution against the possibility of excessive dividends being paid by the directors to the detriment of the company, but as the debt is not paid out of profits this need not be done if otherwise provided. If a substantial surplus is maintained it will suffice, otherwise it is advisable to provide a reserve for bond redemption.

Journal Entries at the time the bonds are issued:

Cash	$5,000,000.00	
To Bond Account		$5,000,000.00

At the end of each six months when coupons are paid an entry will be required:

Bond Interest	$125,000.00	
To Cash		$125,000.00

At the end of the first year when the first installment to the sinking fund is provided for and handed over to the trustee:

Profit and Loss	$167,908.75	
To Sinking Fund Reserve		$167,908.75
Sinking Fund	$167,908.75	
To Cash		$167,908.75

At the end of the second year and each succeeding year the above two entries for the sinking fund installments will be repeated. The accrued interest on the sinking fund for the year ended must also be considered and properly recorded. On the first installment there has accrued interest for one year on $167,908.75 at 4 per cent, $6716.35. If this is handled exclusively by the trustee we need not put it through our cash account but make an adjusting entry:

Sinking Fund (the Trustee)	$6716.35	
To Sinking Fund Reserve		$6716.35

The amount accrued may be put through a sinking fund income account, but that only adds work. Presuming that the income is received in cash and then turned over to the trustee, we have:

Cash	$6716.35	
To Sinking Fund Reserve		$6716.35
Sinking Fund	$6716.35	
To Cash		$6716.35

Answer to Question No. 2.

We see that the same amount of money must be appropriated each year for 15 years, and each installment includes interest on all of the bonds then outstanding as well as part of the principal. The question resolves itself in the first place into an annuity problem, in which we are required to find what equal annual payment is equivalent to $40,000 invested at 5 per cent; in other words, what annuity can be bought for $40,000 when money is worth 5 per cent per annum. Our compound interest tables are of use again, or the annuity tables may be used in solving the problem. The following rule may be of value: To find the amount of an annuity to run a given time that can be bought for a given sum when money is at a given rate: First find the compound amount of the given sum for the given time at the given rate; then divide this by the final value of an annuity of $1 for the same time and at the same rate.

$1.05^{15} = 2.078928$ amount of $1 in 15 years at 5%.

$2.078928 \times 40{,}000 = \$83157.12$ amount of $40,000 for same time and rate.

$$\frac{1.078928 \times 100}{5} = \$21.57856 \text{ final value of \$1, annual payment for 15 years.}$$

$$\frac{83157.12}{21.857856} = \$3{,}853.69\text{, answer.}$$

Aggregate amount of bonds — $40,000.00.

Interest accrued on above end of first year = $2,000.00.

The annual payment is $3,853.69. This includes the first bond and $2,000 for interest on the entire bond issue; deduct $2,000 from $3,853.69 and we have the amount of the first Bond—$1,853.69.

$40,000 — $1,853.69 = $38,146.31, aggregate of the remaining bonds, which will draw interest for the second year.

$38,146.31 × .05 = $1,907.32 = interest accrued at end of second year.

$3,853.69 = sum of second bond and the interest coupon of $1,907.32. Deduct $1,907.32 from $3,853.69 and we have the second bond = $1,946.37.

$38,146.31 — $1,946.37 = $36,199.94, aggregate of remaining bonds.

The same process may be continued from year to year in determining what part of the annual installments belong to principal and what part to interest. It will be noted, however, that each succeeding year the interest is reduced, while the payment on principal is increased.

At the time the bonds are issued and the cash received we make this entry. The term Bonds Payable is used simply as a variation from the entry used in the first question.

Cash	$40,000.00	
To Bonds Payable		$40,000.00

At the end of the first year when the interest is paid and the first bond:

Bond Interest	$2,000.00	
Bonds Payable	$1,853.69	
To Cash		$3,853.69

At the end of the second year:

Bond Interest	$1,907.32	
Bonds Payable	$1,946.37	
To Cash		$3,853.69

Answer to Question No. 3.

This question is an interesting one and often comes up in connection with periodic installments on real estate which have been purchased on the installment plan, of so much per month, quarter, or otherwise, until the principal is liquidated. It is one that can be easily determined by means of the annuity tables.

We see that an annual payment of $2,000 for a given time will liquidate $25,000 and the compound interest on it at 5 per cent. This annuity or sinking fund of $2,000 has a present worth of $25,000 for a certain time at 5 per cent. Then a sinking fund of $1 has a present worth of $25,000 ÷ $2,000 = $12.50 for the required time at 5 per cent. To find the number of years for which $1.00 has a present worth of $12.50 we consult the annuity tables which show "the present worth of $1.00 annuity for any number of years at any rate per cent."

By consulting this table in the column for 5 per cent we find the nearest number to $12.50 to be $12.46221, the present worth of $1.00 for 20 years. Twenty years is therefore the answer, or the number of years required. Again: The amount of the debt, $25,000 at 5 per cent compound interest for twenty years = $66,332.44.

The amount of a sinking fund of $2,000 at compound interest for 20 years = $66,131.91.

Balance due at the end of 20 years, $220.53.

Sinking Funds (Continued).

On First of July, 1910, a company borrowed $100,000 at 4 per cent per annum, payable half-yearly, and payment of loan to be made at end of ten years at 105 per cent. It was decided to set aside annually out of the profits such a sum as would, with interest at 4 per cent per annum, provide for the payment of the premium on the loan at the end of the term.

Solution.

The premium on the loan to be provided for is $5,000; hence, a sinking fund must be created that will at the end of ten years wipe out the premium, with interest compounded at 4 per cent per annum.

The algebraic formula for finding the amount of the sinking fund is:

$$\frac{i}{(1 + i)^X - 1} = X$$

where i is the rate of interest on annuity for 1 period, X is the number of periods.

The equation will then be:

$$\frac{.04}{(1 + .04)^{10} - 1} = \frac{.04}{.48024} = .083291$$

and $.083291 \times 5000. = \$416.46$ = the annual installment to be set aside from profits.

The compounded interest for ten years at 4 per cent. per annum is computed in the following manner:

$(1.04)^2 = 1.0816$

$(1.0816^2 = (1.04)^4 = 1.16986$

$(1.16986)^2 = (1.04)^8 = 1.36857$

$1.36857 \times 1.0816 = (1.04)^8 \times (1.04)^2 = (1.04)^{10} = 1.48024 - 1{,}00000 = .48024$
Compound interest, 10 years, at 4% per annum.

Having found the compound interest on the unit for the time and rate of interest given, the annual installment may be found by first finding the amount of an annuity of $1 by dividing the total interest by the rate of interest.

$$.48024 \div .04 = \$12.006$$

Then $5,000 ÷ $12.006 = $416.46, the annual sinking fund. The ledger accounts will appear as follows:

LOAN ACCOUNT.

Repayable in 10 years at 105 per cent.

		1910 July 1—By Cash	$100,000

INTEREST ON LOAN ACCOUNT.

Dec. 31, 1910—To Cash	$2,000		
July 1, 1911—To Cash	$2,000		
Dec. 31, 1911—To Cash	$2,000		

INVESTMENT ACCOUNT.

1911 July 1—To Cash	$416.46	1911 July 1—By Balance	$416.46
July 1—To Balance	416.46	1912 July 1—By Balance	849.58
1912 July 1—To Cash	433.12		
	849.58		849.58
July 1—To Balance	849.58	1913 July 1—By Balance	1,300.02
1913 July 1—To Cash	450.44		
	1,300.02		$1,300.02
July 1—To Balance	$1,300.02		

SINKING FUND ACCOUNT.

1911 July 1—To Balance	$416.46	1911 July 1—By P. & L. Account	$416.46
1912 July 1—To Balance	849.58	1911 July 1—By Balance	416.46
		1912 July 1—By P. & L. Account	416.46
		July 1—Cash Interest	16.66
	849.58		849.58
		July 1—By Balance	849.58
1913 July 1—To Balance	1,300.02	1913 July 1—By P. & L. Account	416.46
		July 1—By Cash Interest	33.98
	1,300.02		1,300.02
		July 1—By Balance	$1,300.02

Comments.

The question indicates that the Sinking Fund is invested outside the business in gilt-edged securities and allowed to accumulate at compound interest so as to produce exactly $5,000 at the end of ten years; an equal amount should be debited to Profit and Loss account each year and credited to Sinking Fund Reserve Account. An equivalent amount of cash is then invested outside, the annual cash interest from the investment being credited to the Sinking Fund Reserve Account and debited to Investment Account.

When the premium is discharged, the Sinking Fund Reserve Account, still standing with a credit balance which represents a capital liability, should be transferred to General Reserve Account, since the particular purpose for which it was created has ceased to exist.

Formerly the Sinking Fund Account was represented by a specific Cash investment; now it will be represented by the general assets of the business to the extent acquired out of the profits.

It should be borne in mind that the provision of a Sinking Fund for the payment of a liability is not a charge against profits, but an appropria-

tion of them; the provision for a Depreciation Fund, formed for the purpose of replacing an asset, is a direct charge against profit, thus illustrating the profound distinction in principle between the two propositions mentioned.

Again, this question may be raised: In repaying a liability on the Sinking Fund plan, why not make direct annual Cash investments outside the business to meet said liability at maturity, without any charge against Profit and Loss Account at all?

The answer would probably be this: In such a case the balance of the Profit and Loss account would appear out of all proportion to the amount of profits which it would be prudent to distribute.

Furthermore, a judicious and conservative management would militate against the distribution of the whole or greater portion of the profits, while at the same time making annual Cash investments, without forming a Sinking Fund for the redemption of the liability; such operations would seriously affect the financial position of the business.

PARTNERSHIP ACCOUNTS.

Problem No. 1. Pa - 1913

The following proposition is one set by the Pennsylvania State Board of Examiners, whose requirements are of the highest order and not surpassed by any other State Board in the country.

Question.—A is a manufacturer of carpets and his balance sheet at a certain date shows as follows:

ASSETS.

Cash in bank	$ 815.00
Real Estate, appraised value	20,000.00
Machinery, after 10 per cent depreciation	40,000.00
Book Accounts, receivable	7,227.50
Inventory:	
Stock finished	11,000 00
Stock in looms	850.00
Raw material and supplies	107.50
	$80,000.00

LIABILITIES.

Bills payable	$22,000.00
Book accounts payable	28,000.00

He agrees with B to sell him one-half interest in the business for the sum of $20,000.00 to be contributed to new firm, the new firm to take the assets of A, with the exception of Real Estate, and assume all liabilities, and that the good will of the business of A should be rated at $20,000 in the new books. It was discovered shortly after the commencement of

business of the new firm that the inventory of finished stock was incorrect, and that the value should have been stated at $8,500 instead of $11,000, and that of the book accounts receivable only $6,227.50 were collectable, one of the debtors owing $1,000 having failed and absconded, leaving no assets, previous to the formation of the partnership; which fact was known to A, and his bookkeeper had been instructed to charge off the account but failed to do so. No correction was made of these discrepancies, and the trial balance at the end of the year's business showed as follows:

A—Capital Account		$ 25,000.00
B—Capital Account		25,000.00
A—Personal Account	$ 3,100.00	
B—Personal Account	3,100.00	
Merchandise		78,000.00
Book Accounts Receivable	15,400.00	
Expense	1,500.00	
Machinery	40,000.00	
Manufacturing Expense	22,000.00	
Wages	44,000.00	
Rent	1,500.00	
Profit and Loss	600.00	
Book Accounts Payable		45,200.00
Cash	22,000.00	
Good Will	20,000.00	
	$173,200.00	$173,200.00

The inventory at close of year footed up:

Finished Work	$ 28,000.00	
Stock in Looms	1,500.00	
Raw Material and Supplies	1,500.00	$ 31,000.00

No amount has been charged off for depreciation of machinery, which should be 10 per cent. ~~Make proper entries~~ to correct ~~books, and~~ formulate balance sheet showing the standing of the firm, and give reasons for any corrections that may be made.

Comments.

We find in this question a very interesting state of affairs, and though it is not a difficult question it is one that should prove the candidate's ability in adjusting, especially when the short time limit for each answer is taken into consideration. For the young accountant there is probably no other line of accountancy work that will give so much scope for study and analytical drill as the investigation and adjustment of partnership relations. Partnership affairs present so many varying conditions and such a variety of interesting problems, that a mastery of same is not only advised but almost a necessity to the person who would succeed as an accountant.

Before undertaking any adjustment, audit, or appointment, the bookkeeper or accountant should make a careful survey of the field of work to be covered, and before commencing the work should have a carefully out-

lined plan of procedure in order that no time may be wasted while performing the work and to prevent any point being overlooked which is entitled to consideration. The points requiring attention should be noted in the order of their importance and nothing should be overlooked that is in any way in need of inspection or adjustment.

In the question under review we have a case where the proprietor is to admit a partner who upon payment of $20,000 into the firm is to have a half interest in the business and an equal share in future profits. The question does not state that an equal division of profits is to be made, but this is no doubt implied, and without specific directions as to the sharing of profits an equal division is usually made. The business has evidently been established for some time, since A is claiming a good will of $20,000. Without specific information as to past profits and present conditions this amount seems somewhat exorbitant, especially when we note that the Real Estate is to be held out of the transaction and that A's net capital will only be $10,000. Of course this is a matter which does not concern the accountant, since arrangements on all matters have been satisfactorily completed between A and B. When the profits of the succeeding year are considered, however, it can be seen that the business is a profitable one. The Real Estate is owned by A, but is evidently to be used by the firm in order to carry on operations, this fact being verified by the payment of rent during the year. A's net capital, which is now $10,000, plus good will $20,000, gives him a capitalization of $30,000; to this add B's contribution of $20,000, making the firm's capital $50,000, of which each partner is to have one-half, $25,000. For the payment of $20,000, A is voluntarily to reduce his capital to $25,000. If A had considered his good will worth only $10,000, thereby bringing his capital to $20,000, and then had credited B for his investment of $20,000, it would have done just as well; each would have received subsequent profits just as rapidly, and they would still have equal investments. For appearance no doubt they mutually decided to reckon good will as $20,000, as the amount selected now may be an index to future anticipations in providing a larger plan of operations. Indeed, the increase or decrease of the amount of good will has no effect on the standing or profits of the business, but is usually considered only when the sale or incorporation of a concern is under consideration or when published statements are required. As a matter of fact good will could have been omitted entirely without disadvantage to either party, in which case B would pay in his $20,000 as stated, but would receive credit for only $15,000. The additional $5,000 would then go to the credit of A, after which they would each have an investment of $15,000. I mention this method simply to indicate that the consideration of good will in many cases is more for appearance than for financial reasons.

The errors under consideration are large in comparison with A's net investment and would reduce his capital to the extent of $3,500. The entries to adjust them are shown below. It is a principle in partnership relations that the investment of a partner is to be made good by him in case of shrinkage in value or loss in realization of assets to an extent affecting his investment. A must make this amount good by an additional investment, or else receive future profits in accordance with his reduced

capital. The fact that the bookkeeper erred is no excuse and only indicated a degree of carelessness on the part of both employer and employe. As the books now stand, Inventory account has a debit of $2,500 too much and Accounts Receivable $1,000 too much. These accounts must receive credit for the respective amounts and A is to be charged with same. After these entries are made, Accounts Receivable will be reduced to $14,400, and the credit to merchandise will be increased to $80,500. The vague appearance of a Merchandise account, with its meaningless credit balance of $78,000, shows clearly the careless methods of bookkeeping used by the firm. No doubt stock of all kinds, whether finished or unfinished, has been dumped into this account, and it is painfully evident that purchases, sales, returns, allowances, discounts and inventories have been thrown into one account, thereby making it a heterogeneous mass of figures. However, in an actual investigation it is the duty of the accountant to separate the several amounts to the best of his ability in order to present to his client a true statement. In this account we have only the credit balance to guide us and mut be content with it. The gross gain of $45,500 is found by deducting the wages and manufacturing expenses from the credit balance of Merchandise account after the error of $2,500 and the present Inventory of $31,000 have been added. From this deduct other expenses, etc., and we have a net gain of $37,900, as shown in the balance sheet. The balance sheet shows the analysis of each partner's account, but if desired, a separate statement may be made for these details, in which case the balance sheet would show totals only. All profits and withdrawals have been adjusted into the capital accounts, but in practice this is not always done. Many prefer to leave the investments intact in the capital accounts and then make all adjustments of gains, withdrawals, etc., in the private accounts. If this plan had been followed in the present case, A's private account would show a credit balance of $12,350, and B's a credit balance of $15,850, and the investment accounts would remain as they now appear in the trial balance.

Type

BALANCE SHEET.

A and B, as on December 31.

ASSETS.

Book Accounts Receivable	$15,400	
Less loss charged to A	1,000	$ 14,400
Stock and Material:		
Finished Stock	28,000	
Stock in looms	1,500	
Raw material and supplies	1,500	31,000
Machinery	40,000	
Less depreciation, 10 per cent	4,000	36,000

Cash on hand			22,000
Good will			20,000
			$123,400

LIABILITIES.

Book accounts payable			$ 45,200
Capital Accounts:			
A's investment		$25,000	
Add ½ net profits		18,950	
		$43,950	
Deduct:			
Shrinkage of assets	$3,500		
Drawings	3,100	6,600	
A's present capital			37,350
B's investment		25,000	
Add ½ net profits		18,950	
		$43,950	
Deduct:			
Drawings		3,100	
B's present capital			40,850
			$123,400

Note.—Entries for closing the books, etc., are omitted as being unnecessary in answering the question.

Problem No. 2.

The co-partnership of Kimball, Bagley and Pettey find they have merchandise on hand December 31st that cost $8,724 and is inventoried by them at 10 per cent advance; they also have unexpired premiums on insurance amounting to $46.75, and accrued interest on notes receivable amounting to $232.40 not entered on the books; and owe interest on note for $4,000 for nine months at 5 per cent, payable to William C. Bagley. The articles of co-partnership agreement provide that 4 per cent shall be paid each partner on his investment, and in event of partners drawing for personal use they are to pay 6 per cent for such money so drawn, using average date. Profits are to be divided in the following proportion: Jas. H. Kimball, 45 per cent; William C. Bagley, 32 per cent; George R. Pettey, 23 per cent.

The trial balance of the firm and its partners' accounts on the books are as follows:

	Dr.	Cr.
Jas. H. Kimball Investment Account		$ 12,675.00
Wm. C. Bagley Investment Account		9,410.15
Geo. R. Pettey Investment Account		8,011.05
Merchandise	$ 40,425.00	

Expense	1,147.26	
Insurance	162.50	
Freight, Cartage and Express	7,458.98	
Salaries	4,000.00	
Clerk Hire	2,250.00	
Telegraph and Telephone	311.44	
Accounts Receivable	27,816.42	
Notes Receivable	8,640.00	
Notes Payable		10,000.00
Accounts Payable		2,692.65
Interest and Discount	1,118.36	
Jas. H. Kimball Drawing Account	3,750.00	
Wm. C. Bagley, Drawing Account		1,000.00
Geo. R. Pettey Drawing Account	1,425.00	
Returns and Allowances	1,186.79	
Sales		57,551.00
Cash	1,648.10	
	$101,339.85	$101,339.85

	Dr.	Cr.
Jas. H. Kimball, Drawing Account—		
March 10th, withdrew	$1,650.00	
June 22d, withdrew	1,725.00	
July 15th, paid in		$3,000.00
October 1st, withdrew	2,000.00	
Nov. 1st, withdrew	1,000.00	
Dec. 29th, withdrew	375.00	
Wm. C. Bagley, Drawing Account—		
June 1st, withdrew	2,000.00	
Sept. 20th, withdrew	1,000.00	
Dec. 1st, paid in		4,000.00
Geo. R. Pettey, Drawing Account—		
April 1st, withdrew	$ 356.25	
July 1st, withdrew	356.25	
Oct. 1st, withdrew	356.25	
Dec. 31st, withdrew	356.25	

Prepare from the foregoing an income account and balance sheet.

SOLUTION.

Trading Account, December 31st.

Merchandise		$40,425.00	Sales			$57,551.00
Insurance	$162.50		Less			
Less unexpired	46.75		Interest and Disc'nts	$1,118.36		
		115.75	Returns and Allowances	1,186.79		
Freight, Cartage and Express		7,458.98			2,305.15	
		$47,999.73				$55,245.85
Less— Stock in Trade		9,596.40				
Cost of Goods Sold		38,403.33				
Gross Profits		16,842.52				
		$55,245.85				$55,245.85

PROFIT AND LOSS ACCOUNT.

Section I.

Expenses	$ 1,147.26	Balance (being Gross Profits carried down)	$16,842.52
Salaries	4,000.00	Interest on Bills Receivable	232.40
Clerk Hire	2,250.00		
Telephone and Telegraph	311.44		
Interest on Bills Payable, account Bagley	150.00		
	$ 7,858.70		
Ordinary business profits carried down to Section II	9,216.22		
	$17,074.92		$17,074.92

Section II.

Net Profits.

Appropriations:			Balance down from Section I		$ 9,216.22
Reserve for bad debts, 3%		$ 834.50	Interest on Drawings:		
Reserve for 10% advance on inventory values		872.40	Kimball	$176.85	
Interest on Capital at 4%		1,273.50	Bagley	87.90	
Kimball's capital account $507.00; Kimball's fresh investment 56.40	$563.40		Pettey	32.07	
					296.82
Bagley's capital account $376.06; Bagley's fresh investment 13.60	389.66				
Petey's capital account	320.44				
Net Profits		6,532.64			
Kimball, 45%	$2,939.69				
Bagley, 32%	2,090.44				
Pettey, 23%	1,502.51				
		$ 9,513.04			$ 9,513.04

INTEREST CALCULATIONS.

Interest on Partners' Drawings.

Kimball.

Focal Date March 1.

March	10— 10 days	×	1650	=	16500
June	22—113 days	×	1725	=	194925
Oct.	1—214 days	×	2000	=	428000
Nov.	1—245 days	×	1000	=	245000
Dec.	29—303 days	×	375	=	113625
			6750		998050

998050 ÷ 6750 = 148 days from March 1 = July 27, and July 27 to Dec. 31 = 157 days; 6% p. a. on $6,750 = $176.85

INTEREST ON NEW INVESTMENTS.

Kimball.

July 15 — $3,000 to Dec. 31 = 169 days, 4% p. a. = $56.40

Bagley.

December 1 — $4,000, 31 days at 4% p. a. = $13.60

BALANCE SHEET, AS AT DECEMBER 31.

Cash		$ 1,648.10
Accounts receivable	$27,816.42	
Less reserve for bad debts	834.50	
		26,981.92
Notes receivable, all good		8,640.00
Interest on same		232.40
Stock in trade	$9,596.40	
Less reserve	872.40	
		8,724.00
Fire Insurance, unexpired		46.75
		$46,273.17

Notes payable			$10,000.00
Accounts payable			2,692.65
CAPITAL ACCOUNTS.			
Kimball		$12,675.00	
Add—			
45% profits	$2,939.69		
4% interest	563.40		
Paid in	3,000.00	6,503.09	
		$19,178.09	
Less—			
Drawings	6,750.00		
6% interest	176.85	6,926.85	12,251.24
Bagley		9,410.15	
Add—			
32% profits	2,090.44		
4% interest	389.66		
Interest on loan	150.00		
Paid in	4,000.00	6,630.10	
		$16,040.25	
Less—			
Drawings	3,000.00		
6% on drawings	87.90	3,087.90	12,952.35
Pettey		8,011.05	
Add—			
23% profits	1,502.51		
4% interest	320.44	1,822.95	
		9,834.00	
Less—			
Drawing acct.	1,425.00		
6% interest on same	32.07	1,457.07	8,376.93
			$46,273.17

Problem No. 3.

A partnership on equal terms between A and B is dissolved July 1, 1907, the books on that date showing the following:

A's capital paid in was $16,000, and his drawings were $3,500.

B's capital paid in was $2,000, and his drawings were $1,500.

Goods purchased, $50,000; sales, $40,000; business expenses, $1,800. A loss of $1,600 was made on a $5,000 consignment of goods to Liverpool.

In the settlement A agrees to pay B an old debt of $3,500.

Prepare requisite accounts, and show final balance payable by one partner to the other.

SOLUTION.

Balance Sheet at Beginning of Partnership.

Assets	$18,000.00	A's capital	16,000.00
		B's capital	2,000.00

Trading Account.

Purchases	$50,000.00	Sales	$40,000.00
Loss on consignment	1,600.00	Consignment	5,000.00
		Loss in trading	6,600.00
	$51,600.00		$51,600.00

Profit and Loss Account.

Balance from trading account	$6 600.00	A's capital, ½	$ 4,200.00
Expenses	1,800.00	B's capital, ½	4,200.00
Net loss	$ 8,400.00		$ 8,400.00

Cash Account.

A's capital		$16,000.00	Purchases	$50,000.00
B's capital		2,000 00	Expenses	1,800.00
Sales		40,000.00	A's drawings	3,500.00
Consignments	$5,000.00		B's drawings	1,500.00
Losses	1,600.00	3,400.00	Balance	4,600.00
		$61,400.00		$61,400.00
On hand		$ 4,600.00		

A's Capital.

Drawings	$ 3,500.00	Investment	$16,000.00
One-half loss	4,200.00		
To B, old debt	3,500.00		
Balance	4,800.00		
	$16,000.00		$16,000.00
		Balance	$ 4,800.00

B's Capital.

Drawings	$ 1,500.00	Investment	2,000.00
One-half loss	4,200.00	From A, old debt	3,500.00
		Balance	200.00
	$ 5,700.00		$ 5,700.00
Balance	$ 200.00		

Final Balance Sheet.

Cash	$ 4,600.00	A	4,800.00
B	200.00		

A takes all cash on hand, $4,600. Besides which B should pay A $200.

Problem No. 4.

A and B, partners in a mercantile business, share profits and losses equally. At the end of five years the partnership terminates by limitation and the balance sheet shows the following:

ASSETS.		LIABILITIES.		
Plant and Machinery	$15,400.00	Creditors		$30,000.00
Inventory	36,000.00	Bills payable		10,000.00
Accounts receivable	28,000.00	Capital:		
Cash in bank	5,600.00	A	$30,000.00	
		B	15,000.00	45,000.00
	$85,000.00			$85,000.00

Subsequently the business as it stands (except cash in bank) is sold for $30,000. Make final adjustments and closing entries, and show the amount each partner receives.

SOLUTION.

Journal Entries.

1.

Realization and liquidation account	$79,400.00	
To plant and machinery		$15,400.00
To inventory		36,000.00
To accounts receivable		28,000.00
(To close ledger accounts.)		

2.

Creditors	$40,000.00	
To realization and liquidation account		$40,000.00
(To close open ledger accounts.)		

3.

A's capital	$4,700.00	
B's capital	4,700.00	
To realization and liquidation account		$ 9,400.00
(Partners' losses equally divided.)		

Realization and Liquidation Account.

Assets		$79,400.00	Liabilities		$40,000.00
Except cash	$5,600.00		Per balance sheet.		
			Cash		30,000.00
			Loss on realization	$9,400.00	
			A ½ share	$4,700.00	
			B ½ share	4,700.00	9,400.00
		$79,400.00			$79,400.00

A's Capital.

½ loss on realization	$ 4,700.00	Investment	$30,000.00
Cash	25,300.00		
	$30,000.00		$30,000.00

B's Capital.

½ loss on realization	$ 4,700.00	Investment	$15,000.00
Cash	10,300.00		
	$15,000.00		$15,000.00

Cash Account.

On hand	$ 5,600.00	A's capital	$25,300.00
Realization and loss account	30,000.00	B's capital	10,300.00
	$35,600.00		$35,600.00

Problem No. 5.

Messrs. Sharp & Flat, partners, engaged in manufacturing, decide to form a business corporation under the laws of New York, under the name of the Sharp & Flat Manufacturing Company, having an authorized capital of $100,000. The corporation, in consideration of the entire issue of capital stock, purchased all of the assets and assumed all of the liabilities of the partnership, as shown by the following balance sheet, dated May 31, 1912. Sharp & Flat take all the stock except five shares, par value $100 each, issued to incorporators for cash subscriptions.

Balance Sheet, May 31, 1912.

Assets.

Plant and machinery	$35,000
Stock on hand, per inventory	20,525
Accounts receivable	22,750
Bills receivable	1,500
Cash	5,225
Total assets	$85,000

Liabilities.

Sharp's capital	$42,500
Flat's capital	36,300
Accounts payable	5,250
Bills payable	700
Wages due and unpaid	250
Total liabilities	$85,000

During the first year of the corporation's existence the books were kept in the same manner as during the partnership. Soon after the end of the first fiscal year, however, a certified public accountant was presented with the following trial balance, showing the condition of the books on May 31, 1913, and was requested to open a new set of books for the corporation, covering the operations of the business during the past year, and to prepare therefrom an income and profit and loss account and balance sheet.

Trial Balance, May 31, 1913.

Sharp's capital		$ 42,500
Flat's capital		36,300
Plant and machinery	$ 37,500	
Stock on hand, May 31, 1912	20,525	
Sales		131,405
Purchases: Materials and supplies	48,000	
Labor	34,500	
Office salaries	7,000	
Traveling expenses	2,400	
Interest	600	

Stationery and printing	175	
Rent and taxes	4,200	
Discounts and allowances	2,250	
Fuel	4,600	
Insurance	175	
Freight (inward)	1,750	
Commission	6,375	
Advertising	500	
Bills receivable	6,115	
Bills payable		1,100
Accounts receivable	36,115	
Accounts payable		7,850
Cash	6,375	
	$219,155	$219,155

Draft the opening journal entries necessary to give effect to the above, prepare an income and profit and loss account and a balance sheet as at May 31, 1913.

Write off:

(a) Depreciation 5 per cent on plant and machinery.
(b) Unexpired insurance, $75.
(c) Account bad debts, $325.
(d) Inventory, stock on hand, May 31, 1913, $19,605.

SOLUTION.

Opening Entries, as at May 31, 1912.

1.

Subscription account	$100,000	
To capital stock		$100,000

Full authorized issue of 1,000 shares at $100:
Sharp and Flat, 995 shares.
Five incorporators, 5 shares.

2.

Plant and machinery	$ 35,000
Stock on hand	20,525
Accounts receivable	22,750
Bills receivable	1,500
Cash	5,225
Good will	20,700
	$105,700

To accounts payable	$ 5,250	
To bills payable	700	
To labor	250	
To subscription	99,500	
		$105,700

Assets and liabilities of Sharp and Flat turned over to The Sharp and Flat Mfg. Co. in payment of suscribed stock.

3.

(Covering the operation of the business during the past year:)

Plant and machinery	$ 2,500	
Purchases, materials and supplies	48,000	
Labor	34,500	
Office salaries	7,000	
Traveling expenses	2,400	
Interest	600	
Stationery and printing	175	
Rent and taxes	4,200	
Discounts and allowances	2,250	
Fuel	4,600	
Insurance	175	
Freight (inward)	1,750	
Commission	6,375	
Advertising	500	
Wages, old firm	250	
Bills receivable, increase	4,615	
Accounts receivable, increase	13,365	
Cash	1,150	
	$134,405	
To sales		$131,405
To bills payable, increase		400
To accounts payable, increase		2,600
		$134,405

Income Account. Manufacturing Section.

1.

Prime Cost.

Stock on hand, May 31, 1912	$20,525	
Purchases	48,000	
Labor	34,500	
Freight (inward)	1,750	
		$104,775

2.

Works on Cost.

Rent and taxes	$ 4,200	
Fuel	4,600	
Insurance	100	
Depreciation	1,875	
		$ 10,775
Cost of production carried to Trading Section		$115,550

Trading Account.

Cost of production		$115,550	Sales	$131,405	
Commission	$ 6,375		Less discounts	2,250	
Advertising	500				$129,155
Traveling expenses	2,400				
		9,275			
		$124,825			
Less stock on hand		19,605			
Cost of merchandise sold		$105,220			
Gross profits		23,935			
		$129,155			$129,155

Profit and Loss Account.

Office salaries	$ 7,000	Gross profits	$ 23,935
Stationery and printing	175		
Bad debts	325		
Ordinary business profits	16,435		
	$ 23,935		$23,935
Interest	$ 600	Balance	$ 16,435
Net profits (to surplus account)	15,835		
	$ 16,435		$ 16,435

Balance Sheet as at May 31, 1913.

Current Assets.				Current Liabilities.		
Cash		$ 6,375		Bills payable	$ 1,100	
Bills receivable		6,115		Accounts payable	7,850	
Accts. receivable	$36,115					$ 8,950
Less bad debts	325			**Capital.**		
		35,790				
Subscription account		500		Capital stock	$100,000	
Merchandise on hand		19,605		Surplus	15,835	
Unexpired insurance		75				$115,835
			$ 68,460			
Fixed Assets.						
Plant and machinery		$37,500				
Five per cent depreciation		1,875				
		$35,675				
Good will		20,700	56,325			
			$124,785			$124,785

Comments.

The question of $500 cash subscriptions is obscure. The problem states definitely that "Sharp & Flat take all stock, except five shares, par value $100 each, issued to incorporators for cash subscriptions."

The books are silent on the treatment of these subscriptions. What became of them? Pending an explanation, they must remain on the corporation books as a suspended asset.

Next, we turn our attention to the division of the value of the good will. On what basis should it be distributed among the partners? It does not represent a profit; it is an additional asset, an increase to the partners' capital, which at the time of incorporation aggregated $99,500, the amount paid for the stock in the new company. The division should therefore be made in proportion to the partners' respective interests, thus:

Sharp	425/788 of 99500 =	$53,664 =	536.64 shares.
Flat	363/788 of 99500 =	$45,836 =	458.36 shares.
			995. shares.

Problem No. 6 (Merging Partnerships).

Thomas Jones and William Thompson are trading in partnership as wholesale grocery merchants, sharing profits equally. On January 1st, 1912, their balance sheet is as follows:

Assets.		Liabilities.	
Stock in trade	$27,245.00	Bank of B. N. A.	$10,000.00
Furniture	2,752.00	Creditors	27,528.00
Debtors	37,625.00	Jones	25,243.00
Cash	752.00	Thompson	10,603.00
Good will	5,000.00		
	$73,374.00		$73,374.00

An agreement is made to amalgamate with Joseph Smith and George Brown, also trading in partnership, and sharing profits respectively ⅔ and ⅓. Their balance sheet as on January 1st is as below:

Assets.		Liabilities.	
Stock in trade	$35,424.00	Creditors	$35,818.00
Furniture	3,840.00	Smith	22,176.00
Debtors	42,741.00	Brown	27,426.00
Bank of Toronto	3,415.00		
	$85,420.00		$85,420.00

A company is formed to take over the business, under the name of Smith, Jones & Company, Limited, with authorized capital $200,000.00, divided into 2,000 common shares of $100.00 each. George Wilkins, John Lister and Robert Ryder subscribe for 20 shares each, for which they pay cash.

The Jones and Thompson business is taken over at book figures, except that good will is raised to $10,000.00 and $1,000.00 is set up as a reserve for doubtful debts. The Smith and Brown business is taken as shown, with an addition of $15,000.00 for good will and $1,500.00 reserve for doubtful debts. The partners in the two businesses are to take shares

for their interests, making up an even amount by paying cash if required. All cash is deposited in the Bank of British North America.

Show by means of journal entries the various transactions incident to taking over the businesses and allotment of shares, giving the number of shares allotted each party, and make out the balance sheet of Smith, Jones & Co., Ltd.

Comments.

This question is one of six given on Paper 1 of the Final Examination of the Manitoba and Alberta Chartered Accountants, all of which were to be completed in three and one-half hours. A second paper was given on general problems and cost accounts, and it also contained six questions and had to be worked in the same time limit. While none of the problems seemed hard, yet they were comprehensive and covered the ground quite satisfactorily when we consider the limited time in which they were to be completed. The question selected for illustration is by no means the hardest of those given on the examination, yet it contains enough interesting matter to justify its use. Two different firms are to amalgamate and become incorporated under the name of Smith, Jones & Company, Limited, with an authorized capital of $200,000. In Canada, the word "Limited" is required to form a part of the corporate name. It will be noticed that the new corporate name contains also the word "Company," but this is not a necessity. The name could have been Smith & Jones, Limited, had they so desired. The bookkeeping entries are asked for, but in making them there are no specially difficult points involved. They are therefore given below in the order in which they would appear on the Journal of the new corporation. We are asked for the Journal entries illustrating the transition which are taken to mean the entries required on the books of the corporation; but it is obvious that adjusting and closing entries are also necessary on the books of each firm at the time of sale to the company.

The capital of each firm is increased by the consideration of good will and then lessened by an allowance for doubtful debts. Since the problem states just how the partners are to divide profits, we are safe in assuming that the good will is to be apportioned in like manner, also the deduction for doubtful debts. This reasoning does not hold true in every case, however, because good will is more of a capital increase than an increase of profits and, therefore, might be divided in proportion to the partners' investments. Of course, in the present case, and even in any case where the capital of the proprietors is constantly changing because of added profits and deductions for withdrawals, the capital cannot easily be taken as a basis for apportioning the good will or even the profits. It will be seen that the capital of the proprietors, after making adjustments, stands as follows: Jones, $27,243; Thompson, $12,603, making a total of $39,846. Smith, $31,176; Brown, $31,926, making a total of $63,102. Each of the partners is to be charged with even shares of stock in the new company and therefore will be required to make a cash payment to equalize his credit. Capital adjustments are as follows:

Jones & Thompson.

Jones' net capital	$25,243.00		
Add ½ good will	2,500.00		
		$27,743.00	
Less ½ reserve for doubtful debts		500.00	
Present net capital			$27,243.00
Thompson's net capital	$10,603.00		
Add ½ good will	2,500.00		
		$13,103.00	
Less ½ reserve for doubtful debts		500.00	
Present net capital			12,603.00
Net capital of firm			$39,846.00

Smith & Brown.

Smith's net capital	$22,176.00		
Add ⅔ good will	10,000.00		
		$32,176.00	
Less ⅔ reserve for doubtful debts		1,000.00	
Present net capital			$31,176.00
Brown's net capital	$27,426.00		
Add ⅓ good will	5,000.00		
		$32,426.00	
Less ⅓ reserve for doubtful debts		500.00	
Present net capital			31,926.00
Net capital of firm			$63,102.00

Equalizing Subscription Payments.

By Jones	$ 57.00
By Thompson	97.00
By Smith	24.00
By Brown	74.00
Total	$252.00

All cash is to be deposited in the Bank of British North America, thus necessitating a withdrawal from the Bank of Toronto and the deposit of all cash on hand. The bank balance after incorporation amounts to $10,-419.00. This is more than enough to pay the loan of $10,000 owing to the Bank of British North America, but it is a question as to whether or not the loan should be liquidated at this time. Undoubtedly expenses of incorporation will have to be paid, and if the loan were paid off at the same time the funds would be reduced below the amount necessary for general business requirements. It is true, of course, that a new loan could be

made, but in any case it is probable that one or two of the directors would have to become responsible indorsers. The note now held by the bank is no doubt indorsed by both Jones and Thompson. The reserve for bad debts should be shown as a credit in the ledger account though deducted from the accounts receivable on the Balance Sheet itself.

The entries given herewith show the various steps so clearly that additional comments are unnecessary. Instead of bringing the accounts of each firm onto the corporation books separately as shown, the amounts could have been amalgamated into one journal entry. It will be noted that an account has been opened for Unissued Stock, though on the Balance Sheet it is shown as a deduction from the authorized capital.

In addition to the work required on the problem itself, there are other steps necessary in the incorporation of a going concern or of two or more going concerns such as illustrated in this example. The interested parties usually enter into a preliminary agreement to incorporate and to amalgamate their interests. This agreement generally specifies the conditions under which they are to combine their interests as well as the status of each partner after incorporation. After interesting sufficient outside capital and securing the required number of incorporators (five are required in Canada), application for Letters Patent is made to the Provincial Secretary. When this is received the organization meeting is held, at which time each of the old firms offers to exchange entire assets and liabilities for an equivalent amount of the capital stock of the new company, which amount has already been subscribed for by the partners themselves. The proposition is usually accepted by the stockholders and then referred to the board of directors to be carried out. At the first meeting of the directors, the property is accepted and the required amount of capital stock issued in exchange therefor. All personal property must be transferred to the new company by bill of sale, and of course all negotiable paper must be indorsed. Non-negotiable instruments, including insurance policies, contracts, etc., are transferred by assignment, and attention must, of course, be given all other necessary legal requirements. In the incorporation of a company, it is always advisable to have the advice of a competent attorney so that everything may be done in order and according to law.

SOLUTION.

Journal Entries. On Books of the Corporation.

Jan. 1, 1912.

(1)	Unissued Stock	$200,000.00	
	To Capital Stock		$200,000.00

For incorporation of Smith, Jones & Company, Limited, with an authorized capital of $200,000, being 2,000 shares of $100 each, organized to take over as going concerns the business, assets and liabilities of Jones & Thompson and of Smith & Brown.

(2)	Jones	273 shares	$27,300.00
	Thompson	127 shares	12,700.00
	Smith	312 shares	31,200.00

Brown	320 shares	32,000.00	
Geo. Wilkins	20 shares	2,000.00	
John Lister	20 shares	2,000.00	
Robert Ryder	20 shares	2,000.00	
To Unissued Stock			$109,200.00

The above named persons have subscribed for the number of shares of the capital stock of the company set opposite their respective names, per subscription list and articles of incorporation. To be paid for at once as shown below:

(3)	Cash	$6,000.00	
	To George Wilkins		$2,000.00
	To John Lister		2,000.00
	To Robert Ryder		2,000.00

For payment of subscriptions to stock of the company.

The accounts are arranged in the following journal entries in the order in which they shall be placed in the ledger. Instead of opening accounts for the partners, the net capital as shown below could have been credited to Jones and Thompson. In that case the subscription to stock, as shown above, would be changed from the individual names to the firm name of Smith & Brown.

(4)	Cash	$ 752.00	
	Debtors	37,625.00	
	Stock in Trade	27,245.00	
	Furniture	2,752.00	
	Good will	10,000.00	
	To Bank of B. N. A.		$10,000.00
	To Creditors		27,528.00
	To Reserve for doubtful debts		1,000.00
	To Jones		27,243.00
	To Thompson		12,603.00

For the assets and liabilities of Jones and Thompson taken over this day in payment of subscriptions to stock, per agreement and per resolution of stockholders.

(5)	Cash	$ 3,415.00	
	Debtors	42,741.00	
	Stock in Trade	35,424.00	
	Furniture	3,840.00	
	Good will	15,000.00	
	To Creditors		$35,818.00
	To reserve for doubtful debts		1,500.00
	To Smith		31,176.00
	To Brown		31,926.00

For the assets and liabilities of Smith and Brown taken over in payment of stock subscriptions, per resolutions of the stockholders and board of directors.

(6) Cash $252.00
To Jones $57.00
To Thompson 97.00
To Smith 24.00
To Brown 74.00

For payment of balances due on subscriptions to stock, being the amounts required in excess of the net assets turned over by the old firms.

On Books of Old Firms.

The entries already given will open the books of the new company, and of course adjusting and closing entries are required on the books of each firm. We give as follows the entries on the books of Jones & Thompson. The entries for Smith & Brown would be practically the same.

January 1, 1912.

(7) Good will $5,000.00
To Reserve for doubtful debts..........................$1,000.00
To Jones 2,000.00
To Thompson 2,000.00

Agreement has been entered into this day to sell and transfer to the newly incorporated Smith, Jones & Company, Limited, the entire business, assets, liabilities, good will, etc., of this firm for the sum of $39,846, to be paid in the shares of the new company. The shares are to be taken and apportioned in accordance with the capital of each partner after making an increase of $5,000 for good will and an allowance of $1,000 as a reserve for bad debts.

The above entry is for adjustment.

(8) Smith, Jones & Co., Ltd.......................$39,846.00
Bank of B. N. A................................ 10,000.00
Creditors 27,528.00
Reserve for doubtful debts..................... 1,000.00
To Stock in Trade....................................$27,245.00
To Furniture 2,752.00
To Debtors 37,625.00
To Cash 752.00
To Good will.. 10,000.00

For the assets and liabilities of the firm turned over to Smith, Jones & Co., Ltd., in payment for 400 shares of stock, per agreement:

(9) Jones $27,243.00
Thompson 12,603.00
To Smith, Jones & Co., Ltd...........................$39,846.00

To close out the capital accounts upon receipt of stock of the new company:

Shares delivered to Jones....................................273
Shares delivered to Thompson.................................127

Cash was paid out of private funds for balance due on subscriptions to pay for even shares, by Jones, $57, and by Thompson, $97.

Balance Sheet

Smith, Jones & Company, Limited.
At Date of Incorporation, May 1, 1912.

ASSETS.

Deposit in Bank of B. N. A.		$ 10,419.00
Debtors	$80,366.00	
Less reserve for doubtful debts	2,500.00	
		$ 77,866.00
Stock in Trade		62,669.00
Furniture		6,592.00
Good will		25,000.00
		$182,546.00

LIABILITIES.

Bank Loan B. N. A.		$ 10,000.00
Creditors		63,346.00
Capital Stock:		
Authorized	$200,000.00	
Unsubscribed	90,800.00	
		109,200.00
		$182,546.00

CORPORATION ACCOUNTING.

Procedure in Incorporating.

THE FOLLOWING is a brief outline of the official procedure in the incorporation of a company under Pennsylvania laws. With one or two exceptions the procedure in any other state would be the same. Presuming that all preliminary details have been agreed upon, the following steps are necessary:

1. Execute agreement for incorporation in which the status of all interested parties is set forth. This includes all matters and agreements to be fulfilled later between the new company and the several individuals.
2. Execute certificate of incorporation.
3. Execute certified check for $30 in favor of Secretary of the Commonwealth for Issue of Letters Patent.
4. Execute certified check for $1,666.67 in favor of State Treasurer, for bonus of ⅓% of $500,000.
5. Publication of notice of intention to apply for charter.
6. File certificate of incorporation, to remain during period of publication with Secretary of Commonwealth.
7. Recast balance sheets of firms to be incorporated, and show combined statement.
8. Prepare set of by-laws to be presented at first meeting of stockholders.
9. Prepare special notice to be sent to all former customers and creditors giving notice of incorporation, to be sent on the day of incorporation.

10. Prepare other forms and details necessary for use at the first meeting of stockholders, as blanks, stationery, rubber stamps, books, etc.
11. Get seal and stock certificates made to order.
12. File proof of publication of notice.
13. Receive from Harrisburg letters patent and certificate of incorporation.
14. Record charter in office of Register of Deeds and pay fee of $2.50.
15. Meeting of stockholders to confirm all business done.
16. Call and waiver of notice of meeting to be executed.
17. Reading and adoption of by-laws.
18. Adoption of seal.
19. Proposal of old firms to hand over partnership business in payment of stock.
20. Meeting of directors, and filing of call and waiver of notice.
21. Receive proposition of old firm to turn over business as authorized by stockholders.
22. Execution of bills of sale and deed conveying all property, etc., to the new company.
23. Acceptance of transfers of property, and authorization of issue of stock in payment.
24. Official selection of depository and manner of handling funds, signer of checks, etc.
25. Authorization of official stock certificate and issue of stock to all subscribers.
26. Put impression of seal and copy of certificate in minute book.
27. Change bank account or name of same and execute new official signature.
28. Provide new stationery for new company.
29. Indorse over all negotiable papers.
30. Assign all insurance policies, contracts, licenses, leases, etc.
31. Secretary's oath, if necessary.
32. Treasurer's bond, if required.
33. Registration with auditor general.
34. Write up minutes of stockholders' meeting.
35. Write up minutes of directors' meeting.
36. Open up new books for the company.
37. Transaction of new business, etc.

Problem No. 1.

A CORPORATION is formed under the Laws of the State of Pennsylvania with an authorized capital of $1,000,000 in 10,000 shares of a par value of $100 each.

The date of charter is Jan. 1, 1912, at which time they start business with 5,000 shares subscribed for upon which a payment of 20 per cent has been made, the balance to be paid in monthly installments of 10 per cent on the first day of each succeeding month, the first installment being invested in plant.

On Feb. 1, 1912, the corporation purchased the good-will, plant and assets of a manufacturing concern, doing the same kind of business, and

assumed the liabilities of the same for 2,500 shares of the capital stock of the company, full paid and non-assessable.

The floating assets of the purchased company were as follows:

Book Accounts Receivable	$15,000.00
Bills Receivable	18,000.00
Material and Supplies	42,000.00

The liabilities assumed consisted of:

Book Accounts Payable	$23,000.00
Bills Payable	10,000.00

On Feb. 1, 1912, the remaining 2,500 shares of the company were sold on the same terms as the 5,000 shares sold on Jan. 1, 1912.

On July 1, 1912, a dividend of 5 per cent on par value of stock was paid to the stockholders of the company in proportion to their holdings.

On Dec. 1, 1912, by resolution of the stockholders of the company it was determined to purchase another concern in a similar business and issue bonds in payment thereof.

The amount of bonds authorized to be issued were $1,000,000 and the price to be paid for the concern was $650,000 in bonds, bearing interest at 5 per cent, dated Dec. 1, 1912.

The new company to take over all the assets and assume all liabilities of the concern purchased.

The assets consisted of:

Book Accounts Receivable	$50,000.00
Bills Receivable	26,000.00
Material and Supplies	82,000.00

And liabilities were:

Book Accounts Payable	$5,200.00

On Dec. 31, 1912, a dividend of 5 per cent on par value of stock was declared out of the earnings of the corporation, payable to the stockholders in proportion to their interests.

During this year of their existence they purchased material and supplies:

From sundry creditors to the amount of	$1,650,000.00
And for Cash	38,150.00
They have paid for organization of the Company	3,800.00
Counsel Fees	5,000.00
Commissions	50,000.00
Wages, including officers' salaries	626,100.00
They have sold product to the amount of	2,400,000.00
They have received in cash from sundry debtors	2,000,000.00

They have accepted drafts drawn on them by sundry creditors for $1,450,000, of which amount $1,240,000 has become due and paid and have paid them in cash $50,000.

The discount allowed sundry debtors was	$18,250.00
And the discount received from sundry creditors was	14,500.00

It is determined to write off 5 per cent on plant valuation and $5,000 for bad debts.

The value of the stock of material and supplies on hand is $50,000.

Make entries of cash showing cash transactions and prepare balance sheet on Dec. 31, 1912, giving your comments on same.

SOLUTION.

Opening Entries—Jan. 1, 1912.

Subscribed Stock	$500,000.00	
Unsubscribed Stock	500,000.00	
To Capital Stock		$1,000,000.00

"A Corporation" is organized this day under the Laws of the State of Pennsylvania with Authorized Capital, 10,000 shares, Par $100. $1,000,000.00

Subscribed Stock:
5,000 shares, Par $100.......... 500,000.00
20% paid down, balance in monthly payments of 10%.

Unsubscribed Stock:
5,000 shares, Par $100............ $500,000.00

Feb. 1, 1912.

Book Accounts Receivable	$ 15,000.00	
Bills Receivable	18,000.00	
Material and Supplies	42,000.00	
Plant and Good-will	208,000.00	
To Book Accounts Payable		$23,000.00
To Bills Payable		10,000.00
To "A Manufacturing Concern" (Vendors)		250,000.00

As per agreement of this date, the Good-will, Plant and Assets of "A Manufacturing Concern" were purchased, and after deducting outstanding liabilities, were paid for in Stock.

Feb. 1, 1912.

Subscribed Stock	$250,000.00	
To Unsubscribed Stock		$250,000.00

Issue of 2,500 shares of Capital Stock to "A Manufacturing Concern" in full for their equity in Good-will, Plant, Assets, etc., as per agreement.

Feb. 1, 1912.

Subscribed Stock	$250,000.00	
To Unsubscribed Stock		$250,000.00

For sale of remaining 2,500 shares of the Capital Stock, Par $100. Received Cash 20%, balance in monthly installments of 10%.

Dec. 1, 1912.

Book Accounts Receivable	$ 50,000.00	
Bills Receivable	26,000.00	
Material and Supplies	82,000.00	
Plant and Good-will	497,200.00	

To Book Accounts Payable..............		$5,200.00
To "Another Concern" (Vendors)........		650,000.00

The purchase price of Good-will, Plant, Assets, etc., of "Another Concern," for $60,000.00 in payment of which an issue of 5% bonds were made and dated this day.

Dec. 1, 1912.

'Another Concern"	$650,000.00	
To Bonds Payable		$650,000.00

Issue of bonds in favor of "Another Concern" as per agreement this date.

December 31, 1912.

Material and Supplies........................	$1,650,000.00	
To Book Accounts Payable.............		$1,650,000.00

Purchase of material and supplies from sundry creditors during the year.

Book Accounts Receivable....................	$2,400,000.00	
To Sales		$2,400,000.00

For sales during the year to sundry debtors.

Book Accounts Payable.......................	$1,450,000.00	
To Bills Payable.......................		$1,450,000.00

Acceptance of drafts in favor of sundry creditors.

Discounts on Sales...............................	$18,250.00	
To Book Accounts Receivable..................		$18,250.00

Discount allowed to sundry debtors.

Book Accounts Payable..........................	$14,500.00	
To Discount on Purchases.....................		$14,500.00

Discounts allowed by sundry creditors.

(Closing and adjusting entries are omitted to save space.)

Cash Book.

RECEIPTS.

1912			
Jan.	1	Subscribed Stock, 20% down ....$	100,000.00
Feb.	1	Subscribed Stock, 10% (1st instalment)	50,000.00
	1	Subscribed Stock, 20% of new subscription	50.000.00
Mar.	1	Subscribed Stock, installments due ..	75,000.00
Apr.	1	do ..	75,000.00
May	1	do ..	75,000.00
June	1	do ..	75,000.00
July	1	do ..	75,000.00
Aug.	1	do ..	75,000.00
Sept.	1	do ..	75,000.00
Oct.	1	do ..	25,000.00
Dec.	31	Book Accounts Receivable on account	2,000,000.00
		Total Receipts....	2,750,000.00
Dec.	31	Balance	645,700.00

PAYMENTS.

1912			
Feb.	1	Plant ....$	50,000.00
July	1	Dividend Account, 5% on $825.000.00.	41,250.00
Dec.	31	Material and Supplies, cash purchases for year...	38,150.00
		Incorporation Expenses	3,800.00
		Legal Expenses...	5,000.00
		Commissions	50,000.00
		Wages and Salaries	626,100.00
		Bills Payable, acceptances paid..	1,240,000.00
		Book Accounts Payable	50,000.00
		Total Payments.	2,104,300.00
		Balance	645,700.00
			2,750,000.00

Balance Sheet, Dec. 31, 1912.

ASSETS.			LIABILITIES.	
Cash on hand		$ 645,700.00	Accounts Payable	$ 163,700.00
Accounts Receivable		446,750.00	Bills Payable	220,000.00
Bills Receivable		44,000.00	Bonds Payable, Dec. 1, 1912	650,000.00
Plant and Good-will	755,200.00		Dividends Unpaid	50,000.00
Depreciation, 5%	37,760.00	717,440.00	Reserve for Bad Debts	5,000.00
Material and Supplies		50,000.00		
			Total Liabilities	1,088,700.00
Total Assets		1,903,890.00	Capital Stock, fully paid	1,000,000.00
Loss and Gain (Deficiency)		184,810.00		
		2,088,700.00		2,088,700.00

Comments.

There are some interesting points in this problem, and a careful study into the solution would be worth while to the student of accountancy. The plan of working out the parts might be changed somewhat, but the general result would be about the same. The installments on subscriptions to stock are taken as based on the original or face value of the stock; and it is assumed that all payments were actually paid as they came due. On July 1, dividends were to be paid "in proportion to holdings."

This is taken to mean 5 per cent on the amount of installments paid to date on subscriptions plus the full paid stock issued to "A Manufacturing Concern." This dividend was paid on the strength of anticipated profits, but the outcome of the year's business shows very clearly the folly of such a step, and that said dividends were paid out of capital and therefore illegally. This is not an unusual occurrence in corporations, but even if dividends had been paid on the strength of future profits, it was certainly imprudent on the part of the directors to make things worse by declaring an additional dividend of 5 per cent at the end of the year.

The requirements are carried out by making entries for both dividends, but the second one should certainly be rescinded. In case of necessity it might be possible to recover the dividends paid July 1, but the outcome of such an attempt would be doubtful.

It will be noticed that the value of the plant purchased from "A Manufacturing Concern," Feb. 1, is not given, and is therefore included with the item of good-will, making a total of $208,000 for plant and good-will. The same plan is followed in the purchase of "Another Concern" on Dec. 1, and though plant is not mentioned therein, it is assumed from the wording of the problem that both building and machinery are used in the manufacturing operations. This adds another large item of $497,200 to the plant and good-will account. At the end of the year 5 per cent is to be written off plant valuation, but as no exact valuation is given this is reckoned on the entire amount. All of the expense items are charged to Profit and Loss Account, but it would be perfectly proper to spread some of these charges over a period of three or four years. The fixed expenses, however, should include 5 per cent interest accrued on the bond issue of $650,000 for the month of December.

The main comments on the Balance Sheet are that many of the assets appear to be of a doubtful nature, and on this interpretation of the question the company has operated at a loss. The security for bonds outstand-

ing consists largely of Current Assets, but it will be noticed that the Current Liabilities are also large and that the only security left for bondholders would be the item of plant, and we are unable to tell the valuation of same. It would seem that the Accounts Receivable are very heavy when the volume of business done is taken into consideration, yet the condition of the business is by no means alarming, though much of the security for stockholders is based upon the item of good-will. It would seem from the data given that either the wages are too high, the sales too low, or the goods on hand undervalued. From such a large turn-over one would naturally look for substantial profits.

Problem No. 2.

A PROPOSITION has been made for the taking over of three corporations chartered by the state of Pennsylvania by a fourth corporation to be chartered by the same state.

The following statement of affairs has been submitted by the three corporations proposed to be absorbed, and found to be correct.

CORPORATION NO. 1.

Capital Stock (Par value of shares $25.00)	$1,000,000.00
Treasury Stock	100,000.00
Bonded Indebtedness	500,000.00
Treasury Bonds	50,000.00
Accounts Payable	80,000.00
Bills Payable	50,000.00
Cash	50,000.00
Accounts Receivable	180,000.00
Bills Receivable	42,000.00
Supplies	18,000.00
Plant and Franchise	1,250,000.00

CORPORATION NO. 2.

Capital Stock (Par value of shares $50.00)	$1,000,000.00
Bonded Indebtedness	500,000.00
Accounts Payable	10,000.00
Cash	53,000.00
Accounts Receivable	220,000.00
Bills Receivable	80,000.00
Supplies	52,000.00
Plant and Franchises	1,275,000.00

CORPORATION NO. 3.

Capital Stock (Par value of shares $25.00)	$1,000.00

The proposition made to the three corporations is as follows:

Each corporation shall pay its own debts, and distribute among its own stockholders whatever amount shall appear to the credit of profit and loss in closing their books, treating the statements rendered as being correct as to values.

The remaining assets are to be turned over to the promoters of the new corporation on the following terms:

The capital stock of corporations Nos. 1 and 2 at 20 per cent. premium in cash and $100,000.00 in cash to be paid for the capital stock of corporation No. 3.

The bonds of the two corporations will be purchased at a premium of 5 per cent.

The proposition was accepted.

Give closing entries for the books of the old corporations.

Organize the new corporation with a capital of $1,000,000, and increase to such an amount as you may deem necessary, carrying the expenses of incorporation through your cash, including $5,000.00 counsel fees.

Provide for an issue of bonds sufficient to carry out this agreement, said bonds to be sold at 10 per cent discount, and also provide for $150,000.00 bonds in treasury, and give a balance sheet of the new corporation after the organization.

Comments.

This proposition is an excellent one for drawing out the candidate's ability in the analysis of intricate corporate adjustments. Many interesting points are involved, and in some of them the exact interpretation is hard to decide upon. For instance, what "debts" are to be paid by each company is subject to conjecture, since there is not sufficient cash on hand in either of the companies to carry out the agreement. To meet this requirement it is assumed that enough of the accounts receivable have been collected to provide sufficient funds for settlement of current liabilities and for the distribution of surplus profits. If more of the accounts receivable had been realized upon there would be an equivalent amount of cash on hand to be turned over to the new company.

The bonded indebtedness of each of the first two companies is given as $500,000.00, but since Corporation No. 1 has unsold bonds of $50,000.00 it is assumed that only $450,000.00 has been sold. If the term "indebtedness" is interpreted to mean outstanding, then we must increase the amount to $500,000.00. On this basis the purchase price at 105 would be $525,000.00 instead of $472,500.00, as shown in the solution.

The question says to reincorporate the new company for such an amount as may be deemed necessary, and to "issue bonds sufficient to carry out this agreement." This is taken to mean the amount required after the increase of capital stock to provide the funds needed to complete the purchase of stocks and bonds contracted for, including treasury bonds, expenses, etc. To complete the incorporation of the company the capital stock is therefore increased from $1,000.00 to $2,000,000.00 and a bond issue provided for the same amount. The bonded debt might well have been increased, but the valuation of plant which constitutes the security for bondholders is not sufficient to justify.

Treasury stock of No. 1 has been taken as stock which had not been issued, thus leaving a capital outstanding of $900,000.00. Treasury bonds were treated in a like manner, and interest accrued on same not considered.

It is assumed that the consolidation was brought about by promoters through whom the transfers of securities and assets would be made, and the adjusting entries have been made accordingly. Other methods of adjustment may be assumed as readily with similar results. Indeed, the promoters, by means of good-will, might have greatly increased the value of properties turned over to the new company. The bond discount of the

three companies has been charged to the separate franchise accounts in proportion to cost, but it would not be wrong to open a separate account for bond discount.

COMBINED STATEMENTS.

Before and After Liquidation.

	Corporation No. 1		Corporation No. 2.		Corporation No. 3.	
	Total.	Cleared.	Total.	Cleared.	Total.	Cleared.
Assets.						
Plant and franchise...	$1,250,000.00	$1,250,000.00	$1,275,000.00	$1,275,000.00		
Supplies..........	18,000.00	18,000.00	52,000.00	52,000.00		
Cash...............	50,000.00		53,000.00			
Bills Receivable......	42,000.00	42,000.00	80,000.00	80,000.00		
Accounts Receivable..	180,000.00	40,000.00	220,000.00	93,000.00		
Deficit..............					$1,000.00	
Total...........	$1,540,000.00	$1,350,000.00	$1,680,000.00	$1,500.000.00	$1,000.00	
Liabilities.						
Bonds Payable.......	$450,000.00	$450,000.00	$500,000.00	$500,000.00		
Bills Payable.........	50,000.00		10,000.00			
Accounts Payable....	80,000.00		120,000.00			
Capital Stock.........	900,000.00	900,000.00	1,000,000.00	1,000,000.00	$1,000.00	$1,000.00
Surplus..............	60,000.00		50,000.00			
Total...........	$1,540,000.00	$1,350,000.00	$1,680,000.00	$1,500,000.00	$1,000.00	

Note.—The "cleared" column of each company shows the status of the accounts turned over to the promoters of the new company, the stock at 120 and the bonds at 105.

All outstanding debts have been paid, as agreed upon, but to do so part of the accounts receivable had to be collected to provide sufficient cash, as above explained.

If more had been realized from accounts receivable, the "cleared" columns shown in the tabulated statement would show cash on hand and an equivalent reduction in accounts receivable.

Bonds outstanding of Company No. 1 are taken as $450,000.00 on the presumption that the amount authorized is $500,000.00.

It will be seen that No. 3 has no assets listed, and that the surplus of Nos. 1 and 2 had been paid to stockholders.

BOOKS OF CORPORATION NO. 1.

Summary.

The cash paid by the promoters did not go through the books of the liquidating companies but to the individual holders of the stocks and bonds in proportion to their holdings. The amounts to be divided are as follows:

Paid by Promoters—	
For Purchase of Bonds..................................	$450,000.00
For Premium on Bonds................................	22,500.00
For Purchase of Stock.................................	900,000.00
For Premium on Stock.................................	180,000.00
Total Investment	$1,552,500.00

Cash Account.

Dr.	
To Balance	$ 50,000.00
To Accounts Receivable	140,000.00
	$190,000.00
Cr.	
By Bills Payable	$ 50,000.00
By Accounts Payable	80,000.00
By Surplus, dividend to stockholders	60,000.00
	$190,000.00

Adjusting Entries.

1.

Promoters of New Company	$1,350,000.00	
To Sundry Assets		$1,350,000.00
Plant and Franchise	1,250,000.00	
Supplies	18,000.00	
Bills Receivable	42,000.00	
Accounts Receivable	40,000.00	

2.

Capital Stock	$ 900,000.00	
Bonded Indebtedness	450,000.00	
To Promoters of New Company		$1,350,000.00

For assets turned over to promoters of New Company, per agreement, for Capital Stock cancelled and taken, and for assumption of bonded indebtedness.

3.

Capital Stock	$100,000.00	
To Treasury Stock		$100,000.00

4.

Bond Account	$ 50,000.00	
To Treasury Bonds		$ 50,000.00

BOOK OF CORPORATION NO. 2.

Summary of Adjustments.

The cash paid by promoters did not go through the books but to the holders of the securities and treated as in No. 1, and as follows:

Cost to Promoters—	
For Purchase of Bonds	$ 500,000.00
For Premium on Bonds	25,000.00
For Purchase of Stock	1,000,000.00
For Premium on Stock	200,000.00
Total Investment	$1,725,000.00

Cash Account.

Dr.

To Balance	$ 53,000.00
To Accounts Receivable	127,000.00
	$180,000.00

Cr.

By Bills Payable	$ 10,000.00
By Accounts Payable	120,000.00
By Surplus, dividend to stockholders	50,000.00
	$180,000.00

Adjusting Entries.

1.

Promoters of New Company	$1,500,000.00	
To Sundry Assets		$1,500,000.00
Plant and Franchise	$1,275,000.00	
Supplies	52,000.00	
Bills Receivable	80,000.00	
Accounts Receivable	93,000.00	

2.

Capital Stock	$1,000,000.00	
Bonded Indebtedness	500,000.00	
To Promoters of New Company		$1,500,000.00

For assets turned over per agreement, and for assumption of capital and bonded indebtedness—both stocks and bonds having been purchased by said promoters from the holders thereof.

BOOKS OF CORPORATION NO. 3.

Evidently no books have been opened and no doubt the company has recently been incorporated.

There is a capital stock of $1,000.00, but no assets listed.

The promoters paid $100,000.00 to the stockholders for the above stock.

Adjusting Entries.

1.

Promoters of New Company	$1,000.00	
To Deficit (or assets withheld)		$1,000.00

2.

Capital Stock	$1,000.00	
To Promoters of New Company		$1,000.00

For capital stock transferred as per agreement.

Summary of Investment.

Amount paid by promoters to three corporations by which the entire ownership therein is acquired:

Cash Investment.

For Capital Stock of Corporation No. 1.........$	900,000.00	
For Premium of 20%......................	180,000.00	$1,080,000.00
For Capital Stock in Corporation No. 2........	$1,000,000.00	
For Premium of 20%......................	200,000.00	1,200,000.00
For Bonds of Corporation No. 1..............$	450,000.00	
For Premium of 5%........................	22,500.00	472,500.00
For Bonds of Corporation No. 2..............$	500,000.00	
For Premium of 5%........................	25,000.00	525,000.00
For Capital Stock of Corporation No. 3.......$	1,000.00	
For Premiums—or Bonus....................	99,000.00	100,000.00
Total Investment		$3,377,500.00

Note.—It will be seen above that Premiums on stocks and bonds and the stock of No. 3 amount in all to $527,500.00. This may be entered in the books of the New Company as Good-will, or Franchise, or as an additional charge against Plant.

This purchase forms a basis on which to incorporate the New Company, and may be handed over by the promoters at the price paid, or at an increased valuation.

BOOKS OF CORPORATION NO. 4.

Opening Data.

The company is to incorporate for $1,000.00, and then increase to the amount deemed advisable by the candidate.

The entire amount paid for the stocks and bonds of the three companies—$3,377,500.00.

To pay for this amount of assets, the company is to sell its increased capital stock, also the bond issue which is to be floated and sold at 90. The bond issue must be for $150,000.00 more than required for sale, thus providing the treasury bonds called for.

We will increase the capital stock to $2,000,000.00 and provide a bond issue for $2,000,000.00 also.

The bonds are sold at 90 per cent. of face value.

Assume that all of the capital stock but $199,000.00 has been sold at par and fully paid for.

Opening Journal Entries.

1.

Subscribers ....$	1,000.00	
To Capital Stock........................		$ 1,000.00

(For incorporation of company and subscription to Capital Stock.)

2.

Subscribers	$1,800,000.00	
Unsubscribed Stock	199,000.00	
To Capital Stock		$1,999,000.00

(Increase of Capital Stock from $1,000.00 to $2,000,000.00.)

Capital authorized	$2,000,000.00
Subscribed for and paid up	1,801,000.00
Unsubscribed	$ 199,000.00

3.

Treasury Bonds	$2,000,000.00	
To Bonds Payable		$2,000,000.00

Bonds Authorized	$2,000,000.00
Bond Sales	1,850,000.00
Treasury Bonds on hand	$ 150,000.00

Bonds were sold at a discount of 10% as per cash book.

Cash Account (Co. No. 4).

Dr.		Cr.	
To Subscribers	$ 1,000.00	By Incorporation Expenses—	
" Subscribers	1,800,000.00	Bonus, 1/3% on $2,000,000..$	6,666.67
" Treasury Bonds (discount contra)	1,850,000.00	Charter fee	30.00
		Counsel fees	5,000.00
		Other expenses, say	2,000.00
		By Bond discount (10% of sale)	185,000.00
		By Promoters of Company for value of Plants, Franchises and assets of Corporations Nos. 1, 2 and 3	3,377,500.00
		Total Payments	$3,576,196.67
		(See accompanying Journal Entries).	
		By Balance	74,803.33
	$3,651,000.00		$3,651,000.00
To Balance	$ 74,803.33		

Opening Entries (Continued).

Plant and Franchise No. 1	$1,537,536.91	
Plant and Franchise No. 2	1,594,485.66	
Franchise No. 3	105,477.43	
Bills Receivable	122,000.00	
Accounts Receivable	133,000.00	
Supplies	70,000.00	
To Promoters New Company		$3,377,500.00
To Bond Discount		185,000.00

For assets turned over by the promoters of the company—including the amount added for premium, etc. Values per attached statement headed, "Details of Property Received."

INVENTORY VALUATIONS.

Details of Property Received by Company No. 4.

Plant and Franchise Corporation No. 1—		
Original Valuation	$1,250,000.00	
Premium on Stock Purchase	180,000.00	
Premium on Bond Purchase	22,500.00	
Share of Bond Discount, prorated to cost of entire plant, etc	85,036.91	
		$1,537,536.91
Plant and Franchise Corporation No. 2—		
Original Valuation	$1,275,000.00	
Premium on Stock Purchase	200,000.00	
Premium on Bond Purchase	25,000.00	
Share of Bond Discount	94,485.66	
		1,594,485.66
Franchise Corporation No. 3—		
Original Cost	$100,000.00	
Share of Bond Discount	5,477.43	
		105,477.43
Bills Receivable No. 1	$ 42,000.00	
Bills Receivable No. 2	80,000.00	
		122,000.00
Accounts Receivable No. 1	$ 40,000.00	
Accounts Receivable No. 2	93,000.00	
		133,000.00
Supplies from No. 1	$ 18,000.00	
Supplies from No. 2	52,000.00	
		70,000.00
Total Valuation		$3,562,500.00

Note.—The bond discount is prorated to the three companies in proportion to cost.

CORPORATION NO. 4.

Statement of Assets and Liabilities.

ASSETS.

Plant and Franchise No. 1	$1,537,536.91
Plant and Franchise No. 2	1,594,485.66
Franchise No. 3	105,477.43
Supplies	70,000.00
Bills Receivable	122,000.00
Accounts Receivable	133,000.00
Treasury Bonds	150,000.00
Incorporation Expenses	13,696.67
Cash	74,803.33

LIABILITIES.

Capital Stock authorized	$2,000,000.00	
Unsubscribed	199,000.00	
Outstanding		$1,801,000.00
Bond Issue		2,000,000.00
	$3,801,000.00	$3,801,000.00

Note.—A greater division may be made in the above statement if desired to show the apportionments of inventory valuations, premiums, discounts, etc. See analysis in separate exhibit. Franchise consists of the cost of No. 3, plus share of bond discount.

Problem No. 3.

It is proposed to organize for conducting a manufacturing business a small corporation based on certain rights and franchises owned by one of the proposed stockholders in the corporation. The amount of capital stock is to be $100,000. The owner of the rights and franchises agrees to transfer them to the corporation in consideration of $50,000 of the capital stock, though he believes them to be worth much more than that amount. The remainder of the stock is to be sold to produce working capital. Certain capitalists are to be approached for cash subscriptions to the capital stock, but it is uncertain what opinion they will hold concerning the enterprise, and it is desired to have the stock in the treasury in such form that it can be sold below par if necessary. What method would you suggest for accomplishing the object in view? Formulate the journal entries for opening the corporation books.

Journal Entries.

1.

Rights and Franchises, Dr..........................	$100,000	
To Vendor		$50,000
To Working Capital		50,000
(Stock donated to treasury by vendors)		

2.

Vendor, Dr.	$ 50,000	
To Capital Stock		$ 50,000

3.

Treasury Stock, Dr..................................	$50,000	
To Capital Stock....................................		$50,000

Balance Sheet.

Rights and Franchises..............................	$100,000	
Treasury Stock	50,000	
Capital Stock		$100,000
Working Capital		50,000
	$150,000	$150,000

Problem No. 4

A corporation organizes under the laws of the state of New Jersey to conduct a manufacturing business, with an authorized capital stock of $1,000,000 divided equally between preferred and common. Five incorporators each subscribe for 100 shares of the common stock of a face value of $100 per share. John Jones purchases from three manufacturers their fully equipped plants for $950,000 in cash, and turns over the said three plants to the newly incorporated company for the $950,000 of preferred and common stock and $400,000 of first mortgage five per cent bonds, out of a total issue of said bonds in the sum of $500,000, leaving $100,000 of said bonds in the company's treasury.

Prepare opening journal entries with necessary explanations of the transactions and a statement of the company's condition after having acquired the three plants.

Solution.

1.

Subscription Account, Dr.	$50,000	
To Common Stock		$ 50,000

A	100 shares at $100=	$10,000
B	100 shares at $100=	10,000
C	100 shares at $100=	10,000
D	100 shares at $100=	10,000
E	100 shares at $100=	10,000
	500 shares	$50,000

2.

Plants, Dr.	$1,350,000	
To John Jones		$1,350,000

His Cost Price	$ 950,000
His Gain	400,000
	$1,350,000

Book values of Plants, $1,350,000

Plants may also be booked at Cost Price	$ 950,000
and Good Will Acct. opened	400,000
	$1,350,000

3.

John Jones, Dr.	$1,350,000	
To Preferred Stock (5,000 shares @ $100)		$ 500,000
To Common Stock (4,500 shares @ $100)		450,000
To Bonds (First Mortgage 5 per cent Bonds in payment of the three plants acquired.)		400,000
		$1,350,000

4.

Treasury Bonds, Dr.	$100,000	
To Reserve Account		$100,000
Unsold bonds of the $500,000 issue.		

Balance Sheet.

Plants	$1,350,000	Capital Stock Preferred	$ 500,000
Subscriptions	50,000	Capital Stock Common	500,000
Treasury Bonds	100,000	Bonds	400,000
		Reserve Account	100,000
	$1,500,000		$1,500,000

Problem No. 5.

Before making the changes referred to below, the profit and loss account of a corporation for the year shows a credit balance of $60,000. The accounts receivable are $40,700, and the plant and machinery account is $55,000. The 6 per cent preferred stock is $50,000 and the common stock is $150,000. It is decided (a) to provide, out of the above named profit and loss balance 7½ per cent depreciation on plant and machinery; (b) to write off as uncollectable $1,500 of the accounts receivable and to make a reserve of 2 per cent on the remainder of the accounts receivable to provide for possible losses thereon; (c) to provide for the preferred stock dividend for the year; (d) to provide for a bonus of $7,500 to the employes; (e) to provide for a dividend on the common stock of 15 per cent for the year; and (f) to carry the balance then remaining in profit and loss account to undivided profits account.

Draft entries to comply with the above provisions.

SOLUTION.

Journal Entries.

(a)	Loss and Gain	$ 4,125	
	To Reserve for Depreciation		$ 4,125
	A provision of 7½% for depreciation of plant and machinery, per order of the board of directors.		
(b)	Loss and Gain	1,500	
	To Accounts Receivable		1,500
	For bad debts uncollectable and written off as instructed.		
	Loss and Gain	784	
	To Reserve for Bad Debts		784
	A reserve of 2% on accounts receivable $39,200, to provide for possible losses thereon.		
(c)	Loss and Gain	3,000	
	To Dividend, Preferred Stock		3,000
	6% annual dividend on preferred stock as per resolution of board of directors.		
(d)	Loss and Gain	7,500	
	To Bonus to Employees		7,500
	Per resolution of the board of directors.		

(e)	Loss and Gain..................................	22,500	
	To Dividend, Common Stock..................		22,500
	15% annual dividend on common stock, as per resolution of board of directors.		
(f)	Loss and Gain..................................	20,591	
	To Undivided Profits..........................		20,591
	Balance of net profits carried to undivided profits account, per resolution of the board of directors.		

Comments.

A separate entry is made for each transfer or requirement. This is done in order to show clearly the disposition of each item, and to provide suitable explanation for each entry. Indeed, the opportunity provided for showing suitable explanations for each entry or transfer is the main reason for closing accounts by means of journal entries.

The credit balance to Loss and Gain account is $60,000, but before showing the net gain it is necessary to deduct depreciation on plant and machinery, loss of uncollectable accounts, and to provide a reserve to meet possible losses on accounts receivable. The net gain is $53,591, and from the Minute Book of the directors, we get a record of authority for disposing of it in the form of dividends and bonus. The undivided balance of $20,591 is to be held for future use.

For closing entries, instead of making separate entries as shown above, it is usual to make one debit to Loss and Gain for the aggregate amount, and then credit each account separately, and vice versa with the credit accounts. It is hardly necessary to state that the several amounts must be posted separately to Loss and Gain account. The same plan may be followed in apportioning the net gain. It must be observed, however, that in this problem the first entries (a, b, c) are chargeable against profits before the net gain is determined. At this point the Loss and Gain account should be balanced and the balance or net gain carried down for apportionment. Sometimes the net gain is carried direct to Surplus account or to Undivided Profits account, and from there the required amounts transferred to Dividend and Bonus accounts. In such a case the above entries would be changed to suit the plans adopted.

Problem No. 6.

X and Y enter into partnership, X's capital being $20,000, and Y's $15,000. Capital is to bear interest at 10 per cent per annum; profits are to be divided equally between the parties. The profits for the first two years (after charging interest on capital) were:

1st year	$6,000
2d year	7,500

and the drawings of the partners (in excess of salaries) were:

X	$1,500 first year,	$1,750 second year
Y	1,200 first year,	1,500 second year

At the end of the second year, Z was admitted to partnership, and put into the business the same amount of capital as Y had in the business at

that time, and on the same conditions as to interest and division of profits. The profits of the business for the third year were $12,000 and the partners' drawings in excess of salary were:

X	$1,750
Y	1,600
Z	1,500

Construct the capital accounts of the partners for each of the three years, showing the balance of each at the end of the third year.

SOLUTION.

There is nothing out of the ordinary in this question, and no doubt the correct answer hinges on the interpretation of instructions in regard to the disposition of interest on capital and of the net profits. The rate of 10 per cent on capital is not unusual, as the consideration of interest on capital is simply a scheme for an equitable distribution of profits in cases where the investments are unequal, and the rate adopted has nothing to do with the laws of interest and usury even in states where interest rates are not so liberal as they are in some of our great western states.

The partners share profits equally, but since their investments differ, each is to be allowed 10 per cent on this capital before division of the remaining profits is made. It will be seen that each partner in this way takes a part of the profits in proportion to his holdings, after which an equal division is made, but in no case should such interest be considered as an expense or a charge against income.

In many instances the investment of each partner is placed in his capital account and left there intact while profits, interest and withdrawals are adjusted into his private drawing account. In such a case interest is reckoned only on the original investment and any subsequent investments that had been made. In this question, however, we take from its reading that the Capital account contains all of the records for each partner; also, that the salaries and interest for the third year have been taken out, leaving a net gain of $12,000. Since the drawings of partners are from profits earned during the year and not withdrawals of capital, it is deemed unnecessary to allow interest. In fact, if interest were to be considered on the drawings, we have no specified time on which to reckon interest and therefore could only make a guess at the amount to be allowed. The amounts withdrawn may be represented by a series of small charges scattered throughout the year, or, so far as we know, they may have been in totals. This uncertainty in the matter is in itself a valid reason for not considering interest on withdrawals, even though the problem would seem to require it. The partners' capital accounts are shown on the following page.

X's CAPITAL ACCOUNT.

To Drawings	$ 1,500.00	By investment	$20,000.00
Balance, carried down	23,500.00	Interest 10%	2,000.00
		Profits ½	3,000.00
	25,000.00		25,000.00
To Drawings	1,750.00	By balance	23,500.00
Balance, carried down	27,850.00	Interest 10%	2,350.00
		Profits ½	3,750.00
	29,600.00		29,600.00
To Drawings	1,750.00	By balance	27,850.00
Balance, carried down	32,885.00	Interest, 10%	2,785.00
		Profits ⅓	4,000.00
	34,635.00		34,635.00

Y's CAPITAL ACCOUNT.

To Drawings	$ 1,200.00	By investment	$15,000.00
Balance, carried down	18,300.00	Interest 10%	1,500.00
		Profits ½	3,000.00
	19,500.00		19,500.00
To Drawings	1,500.00	By balance	18,300.00
Balance carried down	22,380.00	Interest 10%	1,830.00
		Profits ½	3,750.00
	23,880.00		23,880.00
To Drawings	1,600.00	By balance	22,380.00
Balance, carried down	27,018.00	Interest 10%	2,238.00
		Profits ⅓	4,000.00
	28,618.00		28,618.00

Z's CAPITAL ACCOUNT.

To Drawings	$ 1,500.00	By investment	$22,380.00
Balance carried down	27,118.00	Interest 10%	2,238.00
		Profits ⅓	4,000.00
	28,618.00		28,618.00
		By balance	27,118.00

Problem No. 7.

A company is formed January 1st with a capital of $1,750,000.00, consisting of 17,500 shares of the par value of $100.00 each.

Of these, 16,250 shares are sold to subscribers at par for cash.

The following is a summary of the transactions of the company during the first twelve months of carrying on business:

The preliminary and formation expenses are $12,500.00, which are paid in cash.

They purchase freehold and leasehold current going iron works and collieries from A. B. and Company for $1,250,000.00.

They take over from them the necessary plant and machinery at $375,-000.00, and a stock of iron, coal, etc., at $229,250.00.

The vendors take in part payment of their purchase money $50,000.00 First Mortgage Bonds, and $125,000.00 in shares of the company, fully paid. There is $1,665,000.00 paid to them in cash.

The company expends during the year, $54,200.00 in additions to the plant and machinery by purchase from sundry creditors to the extent of $41,300.00, and by payments through Cash Account amounting to $12,900.00.

They purchase materials from sundry creditors to the extent of $461,-500.00, and they purchase for cash to the extent of $67,310.00. They pay for wages, rents, royalties, tolls, wagon hire, repairs, etc., $842,700.00.

Their sales of iron and coal to sundry debtors amount to $1,526,585.00. They receive in cash from sundry debtors $1,040,700.00.

They draw on sundry debtors' bills to the extent of $419,740.00.

They transfer of the above amount to sundry creditors $54,510.00, and the bank credits their account with $331,400.00, the proceeds of those discounted.

They pay in cash to sundry creditors $231,415.00.

They accept for creditors, bills of exchange to the extent of $142,-110.00; of this amount they meet $86,005.00 through their banking account, the balance being still current at the end of the year. They borrow on First Mortgage Bonds $375,000.00 which is paid into their banking account as received.

They pay to their bankers for interest and commissions $8,040.00; for salaries, office expenses, and management, $15,670.00; law charges, $410.00, and for Directors' and Auditors' fees, $3,010.00.

They write off five per cent from the original amount of the plant and machinery for depreciation, but nothing from the additions.

They also write off the following amounts: $25,000.00 from the freehold and leasehold property to cover minerals taken from the freehold and to provide for the expiration of the leases; $3,005.00 for bad debts, and one-fifth from the preliminary expenses.

The discount allowed to sundry debtors amounted to $5,530.00.

There is due at the close of the year $2,250.00 for interest on bonds, and the value of the stock of materials then on hand is $154,285.00.

All receipts are paid into bank, and all payments made by check.

Prepare Trading and Profit and Loss Accounts and Balance Sheet as at December 31st, showing the result of all the foregoing transactions. Marshall the assets and liabilities, beginning the former with the most liquid asset, and the latter with the liabilities to be first paid.

Criticize in any way that occurs to you the information that the Trading and Profit and Loss Accounts and Balance Sheet give.

Answer and Comments.

The Illinois examination questions are usually of a high order, and this one is no exception. Three hours were allowed in which to provide a solution. There are points in it, however, that might be subjected to criticism, and yet this was no doubt intentional on the part of

the examiners, since they have asked for a criticism of the information submitted. The company has made sales amounting to $1,526,585, but all of this has been eaten up in operating and administrative expenses, leaving a Net Loss for the year of $4,055.00. This seems unreasonable, and no doubt it would be even greater if all of the expenses and charges were included. The outlay for royalties, tolls, wagon hire and repairs aggregates $842,700.00, or a little more than 50% of the sales. Evidently that is too much or else the sales are too low. The inventory of material on hand is given as $154,285.00, a very low amount for a company dealing in such large proportions. This is taken as including both material and stock of iron and coal. If it contains material only, then the stock has been either depleted or overlooked. Possibly the inventory was taken at the cost price. By rights it should include a portion of the operating charges, but we are not told whether it does or not. If we assume that operating charges are to be added, it is apparent that the net loss will be changed into a net profit, since the charges are more than 100% of the cost of stock and material. Discounts allowed to customers usually appear in the cash book, but in this case we show them in the journal.

We are asked to prepare trading and profit and loss accounts, which are included in one exhibit as shown herewith. A balance sheet is called for also. To marshall the assets and liabilities means to array or arrange them in order. In order to properly assemble the details and exhibits, all postings should be made from the cash book and journal to the ledger accounts. In working up matters of this kind the accountant usually has his working papers or working sheets upon which he summarizes and analyzes his information. These are always kept for future reference. If accounts are opened it is apparent that a trial balance should be made.

Bonds were issued to the extent of $425,000.00 It is very probable that the entire bond issue was passed upon by the directors and stockholders at the beginning of the year. At that time only $50,000.00 were issued, while the remainder was sold later in the year. It is not probable that two separate bond issues would be sanctioned in one year. If they were all sanctioned at the one time, we could have debited Treasury Bonds for the amount unissued. First Mortgage Bonds should of course be credited for the aggregate amount. Evidently the bonds draw 4½% payable yearly, since there is $2,250.00 of bond interest due on December 31st. This is exactly 4½% of $50,000.00 for one year. It is reasonable to suppose that the additional bond sale of $375,000.00 has some interest accrued. Since we do not know their date of issue the amount of accrued interest is omitted. Bonds sold after the date of issue usually include payment for the accrued interest, but no interest has been mentioned in this case. Commission to the bankers for selling the bonds is undoubtedly included in the $8,040.00 of interest and commissions.

It is evident that a greater division of operating and administrative expenses should have been made. The problem deals too largely in generalities instead of being specific. In allowing $25,000.00 for extinguishment of leases, it is apparent that the expiration of the lease and the exhaustion of the mine are based on a period of fifty years. Freehold has reference no doubt to full ownership and leasehold to properties rented or

leased for a given time, but we are not able to distinguish in this case between the purchased and leased properties. In the sales, division should have been made as between sales of material bought and sales of the company's own production. The quantities of material purchased and mined are not specified.

The section pertaining to drafts drawn on customers is not clear. It states that they drew on sundry debtors bills to the extent of $419,740.00. We are not told whether or not these are sight or time drafts, nor when they were issued, nor whether or not any of them have been paid. We assume them to be time drafts, due partly to the fact that the bills of exchange which the company itself accepted had evidently a given time to run. Of the bills drawn, $54,510.00 have been transferred to sundry creditors and charged to their accounts. The problem states that bills discounted amount to $331,400.00, but it does not tell whether this is the "proceeds" after discounting or simply the sum advanced on account of said security, or whether or not they have all been transferred to the bank. We will assume that this $331,400.00 represents the face value of drafts transferred to the bank, and that the bank discount is included in the $8,040.00 charged up to interest and commission. Any other assumption might even be made in connection with this item. Both the drafts discounted and those transferred to sundry creditors as shown as a credit to bills discounted. When they are paid an entry will be required debiting bills discounted and crediting bills receivable.

The reserve for bad debts of $3,005.00 does not state on what amount the estimate is made nor at what rate per cent. No provision has been made for the payment of bonds when they mature. Unless they are payable serially, it is customary to create a sinking fund for their redemption. Probably the intention is to refund them at maturity. The reason for issuing bonds is not apparent since the cash balance amounts to $427,-140.00. This will no doubt be used for development purposes in the near future. Cash book and journal entries are given as an aid in tracing the various transactions and in collating the ledger accounts. Accounts receivable and payable would be better terms than sundry debtors and creditors. Since all cash has been deposited, the bank balance will equal the cash balance.

Trial Balance, December 31.

(Before making adjustments.)

Capital Stock		$1,750,000
Cash and Bank	$ 427,140	
Iron Works and Collieries	1,250,000	
Plant and Machinery	429,200	
A. B. & Company		14,250
Incorporation Expenses	12,500	
First Mortgage Bonds		425,000
Sundry Creditors		74,765
Sundry Debtors	60,615	
Bills Payable		56,105
Bills Receivable	419,740	

Bills Receivable Discounted		385,910
Bond Interest Payable		2,250
Iron and Coal Purchased	758,060	
Wages and Operating Expenses	842,700	
Iron and Coal Sales		1,526,585
Interest and Commissions	8,040	
Salaries, Office Expenses and Management	15,670	
Law Charges	410	
Directors' and Auditors' Fees	3,010	
Cash Discounts	5,530	
Bond Interest	2,250	
	$4,234,865	$4,234,865

Cash and Bank Account.

RECEIPTS.

Unissued Stock.	
Sale of 16,250 shares at par	$1,625,000
Sundry Debtors	
To apply on account	1,040,700
Bills Receivable Discounted	331,400
Proceeds of bills discounted at bank.	
First Mortgage Bonds	375,000
	$3,372,100

PAYMENTS.

Incorporation Expenses	$ 12,500
Incurred during incorporation—	
A. B. Company	$1,665,000
On account of purchase	
Plant and Machinery	12,900
Additions and betterments	
Iron and Coal	67,310
Material purchased for cash	
Wages and Operating Expenses	842,700
For wages, rents, royalties, tolls, wagon hire, repairs, etc.	
Sundry Creditors	231,415
To apply on account	
Bills Payable	86,005
For acceptances paid	
Interest and Commissions	8,040
Salaries, Expenses, Management	15,670
Law Charges	410
Directors' and Auditors' Fees	3,010
Total Payments	$2,944,960
Balance in Bank	427,140
	$3,372,100

Journal Entries on Company's Books During the Year.

(1)	Unissued Stock	$1,750,000	
	To Capital Stock		$1,750,000
	For incorporation of A. B. & Company with a capital of 17,500 shares of $100 each.		
(2)	Iron Works and Collieries	1,250,000	
	Plant and Machinery	375,000	
	Stock of Iron and Coal	229,250	
	To A. B. Company		1,854,250
	For purchase of iron works and collieries, plant and machinery, and stock of iron, coal, etc. Terms of purchase as below.		
(3)	A. B. & Company	175,000	
	To First Mortgage Bonds		50,000
	To Unissued Stock		125,000
	Given in part payment of purchases, as above. Bonds and stock issued at par value.		
(4)	Plant and Machinery	41,300	
	To Sundry Creditors		41,300
	For additions to plant and machinery purchased from sundry creditors.		
(5)	Iron and Coal	461,500	
	To Sundry Creditors		461,500
	For purchase of materials.		
	Note—We assume that the material consists of coal and iron ready for sale.		
(6)	Sundry Debtors	1,526,585	
	To Sales		1,526,585
	For sales during the year of iron and coal.		
(7)	Bills Receivable	419,740	
	To Sundry Debtors		419,740
	For bills drawn on sundry debtors on account of sales.		
(8)	Sundry Creditors	54,510	
	To Bills Receivable Discounted		54,510
	For bills receivable transferred to apply on account.		
(9)	Sundry Creditors	142,110	
	To Bills Payable		142,110
	For acceptance of bills of exchange.		
(10)	Discount on Sales	5,530	
	To Sundry Debtors		5,530
	For allowances during the year.		
(11)	Bond Interest	2,250	
	To Bond Interest Payable		2,250
	For interest on $50,000 bonds one year at 4½%.		

Closing Entries on December 31.

(12)	Profit and Loss ....$	49,255	
	To Sundries:		
	Reserve for depreciation of plant and machinery		18,750
	(5% of $375,000.)		
	Reserve for Expiration of Leases (or freehold and leasehold)..................		25,000
	Reserve for bad debts....................		3,005
	(—% of sundry debtors.)		
	Incorporation Expenses		2,500
	(1-5 of original expense.)		

Trading and Profit and Loss Account for Year.

RETURNS.

Sales of Iron and Coal......................			$1,526,585
Purchases of Iron, Coal, Material:			
From A. B. & Company.................	$229,250		
During the year.......................	528,810	$758,060	
Less Inventory of Material, Dec. 31....		154,285	
Cost of Stock sold.................		$603,775	
Add Wages and Operating Expenses.........	$842,700		
Depreciation of plant and machinery.....	18,750		
Depreciation of Iron Works and Collieries	25,000	886,450	
Total operating and trading charges..........			1,490,225
Gross profit from trading..............			$ 36,360

GENERAL AND ADMINISTRATIVE EXPENSES.

Salaries, Office Expenses and Management............	15,670	
Law Charges	410	
Directors' and Auditors' Fees........................	3,010	
Reserve for Bad Debts............................	3,005	
Interest and Commissions........................	8,040	
Interest on Bonds, due..........................	2,250	
Interest Accrued on Bonds........................	nil	
Discounts to Customers........................	5,530	
Incorporation Expenses written off..................	2,500	
Total General and Administrative Expenses......		40,415
Net Loss for Year..............................		$ 4,055

Note—It would be good practice to determine the net profit from business operations before deducting bond interest, interest and commissions, etc.

Balance Sheet as of December 31.

ASSETS.

Current Assets:				
Cash in Bank................			$ 427,140	
Sundry Debtors			60,615	
Bills Receivable		$419,740		
Less:				
Bills Discounted	$331,400			
Bills Transferred	54,510	385,910	33,830	$ 521,585
Inventories:				
Stock of material on hand......................				154,285
Fixed Assets:				
Iron works and collieries.......................			$1,250,000	
Plant and machinery...........................			429,200	
				1,679,200
Deferred Charges:				
Incorporation expenses				10,000
Total assets				$2,365,070

LIABILITIES AND CAPITAL.

Current Liabilities:		
Sundry creditors	$ 74,765	
Bills payable outstanding.....................	56,105	
A. B. & Company balance.....................	14,250	
Bond interest due.............................	2,250	
Bond interest accrued..........................	nil	147,370
Fixed Liabilities:		
First mortgage bonds..........................		425,000
Reserve Accounts:		
Depreciation of plant and machinery............	18,750	
Expiration of leases...........................	25,000	
For bad and doubtful debts....................	3,005	46,755
Total Liabilities		$ 619,125
Capital and Profits:		
Capital Stock outstanding......................	$1,750,000	
Less Net Loss for year...........................	4,055	
Present Net Worth.......................		1,745,945
Total Liabilities and Capital................		$2,365,070

Note—Attention is called to the contingent liability on bills discounted and transferred to creditors.

Problem No. 8—Consolidation.

The Smith Mfg. Co., the Jones Mfg. Co., and F. Macdonald, Inc., amalgamated their interests on January 1, 1909, and organized the Consolidated Mfg. Co., with an authorized capital stock of $2,000,000.00 divided into 20,000 shares, par value, $100.00. The individual balance sheets of each respective firm taken to represent the true and exact condition of affairs at that date are as follows and the agreement among the subscribers to the stock is also stated.

Smith Mfg. Co.

Plant and Machinery		$ 50,000.00	Mort. on plant (5% interest)	$ 25,000.00
Real Estate and Buildings		40,000.00	Bills Payable	14,000.00
Furniture and Equipment		20,000.00	Accounts Payable	24,000.00
Horses and Trucks		10,000.00	Capital Stock	125,000.00
Raw Materials	$19,000.00		Surplus	15,000.00
Finished Goods	32,000.00			
Supplies	4,000.00			
		55,000.00		
Bills Receivable		9,000.00		
Accounts Receivable		12,000.00		
Cash		7,000.00		
		$203,000.00		$203,000.00

Jones Mfg. Co.

Plant, Equip. and Machy	$100,000.00	Mort. on bldgs	$100,000.00
Real Est. and Bldgs	250,000.00	Int. Acct. on Bldgs. Mort.	1,125.00
Horses and Wagons	18,000.00	Bank Loans	14,500.00
Office Equip.	2,000.00	Bills Payable	67,275.00
Inventory, Fin. Goods, etc.	118,000.00	Ac. Payable	47,100.00
Bills Rec	22,000.00	Dividends Payable	30,000.00
Ac. Rec.	119,000.00	Capital stock	300,000.00
Loans Rec.	16,000.00	Surplus	87,000.00
Cash	30,000.00	Reserve for Depreciation	22,500.00
		Reserve for Bad Debts	5,500.00
	$675,000.00		$675,000.00

F. Macdonald, Inc.

Plant and Machy	$ 75,000.00	Ac. Payable	$111,000.00
Inventories	76,500.00	Capital Stock	150,000.00
Ac. Rec.	82,500.00	Surplus	39,000.00
Cash	66,000.00		
	$300,000.00		$300,000.00

The average yearly net profits of each respective firm for a period of five years have been as follows:

Smith Mfg. Co.	$19,020.00
Jones Mfg. Co.	47,400.00
F. Macdonald, Inc.	15,120.00
	$81,540.00

Of the total capitalization $1,600,000 to be issued to the incorporators for the properties and goodwill to be sold to the new company after the assumption of all liabilities of each respective firm, $400,000.00 to be offered for sale to the public.

Vendor firms to donate 1,000 shares treasury stock to be available as a bonus if necessary to the sale of the 4,000 shares as yet unissued.

The 15,000 shares issued and outstanding with vendors to be allocated among them as follows:

(A) Each vendor firm to receive an amount of stock equal to the net assets, including cash, of his firm.

(B) Each vendor firm to receive also additional stock equal to the capitalized net earnings of his respective firm, at 6%, after deducting from the amount to be capitalized 6% of original investment (capitalization).

(C) Such stock as is then unallotted to be divided between the vendor firms share and share alike.

The Consolidated Mfg. Co. continued operations for one year, at the end of which it showed profits of $190,000.00 before allowing for depreciation and before providing a reserve for possible bad debts.

It sold during the year the 4,000 shares of stock at par, giving as a bonus 400 shares of the treasury stock.

It also sold 500 additional shares of the treasury stock at $85.00 per share.

It is reported that the profits of $190,000 mentioned above were represented by an increase in cash $42,000.00, additional mehchandise to the amount of $12,000.00, increase in accounts receivable $48,000.00, decrease in accounts payable $88,000.00.

You are asked to submit the following:

1. Closing entries for the books of Jones Mfg. Co.
2. Opening journal entries for the books of the Consolidated Mfg. Co.
3. Journal entries to create from the profit of $190,000.00 a reserve for depreciation, and a reasonable reserve for bad debts. The amount in each case being your own estimate with reason.
4. Journal entries showing declaration and payment of a 6% dividend.
5. Final balance sheet of the Consolidated Mfg. Co.
6. Statement showing the amount of stock that each vendor firm is to receive.

Answer and Comments.

This excellent question has been presented for solution without advice as to what state examination it came from. The practice nowadays for business concerns, whether corporations or otherwise, is to combine their interests for mutual protection and advantage, and it behooves the student of accountancy to study the methods of procedure back of and underlying such mergers and combinations. Of course the laws of the various states are not uniform in respect to mergers and holding companies, and because of this fact the accountant concerned with such matters must first of all familiarize himself with the statutory requirements of the state wherein the companies are located and where the combine is to conduct operations. Indeed the student should familiarize himself with the corporation laws of his own state and then adapt the details of this solution to them. In doing so, it may be found advisable to alter the plans that are here outlined in order to comply with state requirements.

It will be seen that the three corporations merge their interests and become a single operating company under the name of "Consolidated

Manufacturing Company." We are not told whether or not the three plants are to continue operations as before nor which one, if any, is to be the main plant or home office. The home office may be located in one of the plants or be in a different locality entirely. It would seem unwise to close down any plant which has heretofore been returning a fair dividend on the investment, and we can only assume that all are to be continued in operation as branches of the consolidated company. It is assumed of course that the capital stock of each separate company has been cancelled and the charter forfeited to the state. In doing this, certain legal steps and requirements must be followed in order to legalize both the dissolution of the separate companies and the incorporation of the new company. In allotting shares of the new company to the stockholders of the merging company, each stockholder will receive new stock in exchange for the old in the proportion shown in the statement herewith.

The donation of stock back to the company is a common practice and such donated stock is known as "Treasury Stock" or as "Donated Stock," and it may be either given away or resold at any price decided upon without subsequent liability to the holders thereof. The stock given away is known as "Bonus Stock," and should be charged to profit and loss and spread over a term of three or four years. In this case it is entered as an offset against Working Capital which account was credited at the time of donation. The discount on treasury stock disposed of may also be charged to Working Capital. An examination of the journal entries herewith will show the steps in opening the books of the new company and in closing the books of the Jones Manufacturing Company. A similar procedure is necessary in closing the books of the other two companies, which of course must take place at the time transfers are made. Each of the old companies may continue to keep books as a branch house and make reports accordingly to the head office either daily, weekly or monthly in accordance with the accounting system in use.

The capitalization of the new company is $2,000,000 and $1,600,000 of this amount is allotted to the old companies in accordance with instructions. A summary of this adjustment is given herewith and should be studied with care. After deducting 6% of the former capital from average profits we divide the result by 6% in order to get a capitalization. This capitalization is considered Goodwill, and also the additional $100,000 divided among the three former corporations share and share alike. This is taken to mean that each company is to get one-third. In adjusting the profits of $190,000, it is necessary first to set aside a sufficient amount for the reserves as shown in the statement herewith. Arbitrary selections have been made and the amounts might even have been more or less. The reserve for bad debts is taken at 2% since the reserve already amounted to $5,500. It now amounts to $10,730 and equivalent to something over 4% on the outstanding accounts. This should be sufficient to cover all losses in making collections.

In making opening entries on the new books a different procedure might even be followed. The assets and liabilities of each company may be brought into the books of the new company separately, if desired, and not collectively as shown herewith. It is good practice to make up a

complete Consolidated Balance Sheet of the assets and liabilities of the old companies before they are entered on the new books. After that is done it is an easy matter to enter them in totals as illustrated. As an alternative, we might say that each company turns over its entire plant, etc., in payment of the stock allotted to it, at which time a separate enry should be made. That is good practice. Such assets and liabilities are in payment of subscriptions and it may be reasonably contended, should be entered separately and not in conjunction with the accounts of other companies. In the end like results are obtained though the reader may use his own judgment in deciding upon the method that he should follow. The balance sheet as at the end of the year is here shown with the additions and deductions suggested. It is assumed that the dividend of the Jones Company was paid off in cash before any transfers were made. It may be carried into the books of the new company if desired and then paid without altering the results in any way. The new dividend does not include treasury stock. Since this stock is held by a trustee a dividend could be paid to him, but it would immediately be returned to the company and credited to Surplus. Nothing would be gained by such payment. It will be noted that the journal entries differ slightly from those used in some other illustrations of mergers. This simply emphasizes the fact that different plans of setting up entries are in vogue. Instead of placing the reserves among the liabilities, they may be deducted from the assets against which they apply.

It will be seen that the Goodwill of the respective companies is determined by capitalizing the net average on a 6% basis after deducting 6% of the original investment. To this is added $100,000 for unallotted stock which has been divided equally among the three concerns, which stock has been donated back to the company to provide working funds. The stockholders of each company will have to adjust stock allotments according to their respective holdings, since fractional parts of new shares are receivable in exchange for the old. Even shares will no doubt be issued and then money payments made to equalize amounts. The accountant usually prepares a report or letter for presentation to his client along with the statements and exhibits.

Disposition of Capital Stock.

Statement showing the manner of dividing the $2,000,000 of Capital Stock of the New Company.

Disposition under	Shares	Amount
A		
For Net Assets	7,160	$ 716,000.00
B		
For Capitalized Profits	7,840	784,000.00
C		
Division of remaining 1,000 shares	1,000	100,000.00
Total issued to vendor companies	16,000	$1,600,000.00
Sold to Public	4,000	400,000.00
Total Capital	20,000	$2,000,000.00

Note—Shares issued to vendors for goodwill, 8,840, of which 1,000 shares are donated to the company. This leaves them with $1,500,000, or 15,000 shares.

Allotment of Stock in New Company.

Company	Shares	Amount	No. shares new Co. for one of old.
Smith Co.	3,320	$ 332,000	2 and 82–125ths
Jones Co.	8,770	877,000	2 and 277–300ths
Macdonald	2,910	291,000	1 and 47– 50ths
Total	15,000	$1,500,000	

Requirement 1.

Closing Entries for the Books of the Jones Manufacturing Company.

All the assets, including goodwill and liabilities of this company are transferred as of this date to the Consolidated Manufacturing Company, under agreement. The Capital Stock of the Consolidated Manufacturing Company received under the agreement is distributed pro rata to the stockholders of the company, except that 334 shares are donated to said Consolidated Company. The Capital Stock of this company is surrendered and cancelled. This company pays to its stockholders in cash the dividend of ten per cent on its capital stock already declared.

(1)	**Consolidated Mfg. Company to Sundries**		$645,000.00
	For sundry assets transferred to them, as follows:		
	Plant, equipment and machinery	$100,000.00	
	Real estate and buildings	250,000.00	
	Horses and wagons	18,000.00	
	Office equipment	2,000.00	
	Inventory, finished goods, etc	118,000.00	
	Bills receivable	22,000.00	
	Accounts receivable	119,000.00	
	Loans receivable	16,000.00	
(2)	**Sundries to Consolidated Mfg. Company**		258,000.00
	For sundry liabilities assumed by them as follows:		
	Mortgage on buildings	100,000.00	
	Interest account on building mortgage	1,125.00	
	Bank loans	14,500.00	
	Bills payable	67,275.00	
	Accounts payable	47,100.00	
	Reserve for depreciation	22,500.00	
	Reserve for bad debts	5,500.00	
(3)	**Consolidated Manufacturing Company Stock**		
	To Consolidated Manufacturing Company		910,400.00
	For 9,104 shares of the capital stock of the Consolidated Manufacturing Company at the par value of $100, issued to this company.		

(4)	Consolidated Mfg. Co.	523,400.00	
	To Surplus		523,400.00
	To close the former account, this amount being excess capital stock of the Consolidated Manufacturing Company over net assets transferred to them as per above entries, and represents value of goodwill contemplated in the agreement as per accompanying statement.		
(5)	Dividend	30,000.00	
	To Cash		30,000.00
	For dividend declared....paid in cash this date as per checks Nos. .... to .... on the.... National Bank.		
(6)	Surplus	33,400.00	
	To Consolidated Mfg. Co. Stock		33,400.00
	For 334 shares of the latter stock donated to the Consolidated Manufacturing Company under agreement.		
(7)	Capital Stock	300,000.00	
	To Sundry Stockholders		300,000.00
	For full amount of the capital stock of this Company surrendered by stockholders and cancelled.		
(8)	Surplus	577,000.00	
	To Sundry Stockholders		577,000.00
	To close Surplus account with the purpose of distributing same to stockholders.		
(9)	Sundry Stockholders	877,000.00	
	To Consolidated Mfg. Co. Stock		877,000.00
	For 8770 shares of the latter stock, at the par value of $100 per share, distributed pro rata to the former stockholders of this company.		

Requirement 2.

Opening Journal Entries for the Books of the Consolidated Mfg. Co.

(1) Sundries to Sundry Vendors..........................$2,032,000.00

For sundry assets transferred to this Company in pursuance of an agreement dated .... by and between the Smith Manufacturing Company, the Jones Manufacturing Company, and F. Macdonald, Inc., whereby their respective interests are amalgamated as of this date, the consideration for such assets and goodwill, less liabilities assumed by this Company, being 16,000 shares of the capital stock of this Company, at the par value of $100 per share. The following entries are made to open the books of this Company:

Debits	Smith	Jones	Macdonald	Total
Plant and Machinery..........	$ 50,000	$100,000	$ 75,000	$225,000
Real Estate and Buildings......	40,000	250,000		290,000
Furniture and Fixtures........	20,000	2,000		22,000
Horses and Wagons..........	10,000	18,000		28,000
Inventories	55,000.	118,000	76,500	249,500
Bills Receivable	9,000	22,000		31,000
Accounts Receivable	12,000	119,000	82,500	213,500
Loans Receivable		16,000		16,000
Cash	7,000		66,000	73,000
Goodwill	225,300	523,400	135,300	884,000

(2) **Sundry Vendors to Sundries**..............................$432,000

Credits	Smith	Jones	Macdonald	Total
Mortgages Payable	$ 25,000	$100,000		$125,000
Bills Payable	14,000	67,275		81,275
Accounts Payable	24,000	47,100	111,000	182,100
Bank Loans		14,500		14,500
Mortgage Interest Payable.....		1,125		1,125
Reserve for Depreciation.......		22,500		22,500
Reserve for Bad Debts........		5,500		5,500

(3) **Sundries to Capital Stock...** $2,000,000

For authorized capital stock of this Company, namely 20,000 shares at the par value of $100 per share, allotted as follows:

Sundry Vendors $1,600,000.00

Issued to Smith Mfg. Co.......3,653 shares
Jones Manufacturing Co.......9,104 shares
F. Macdonald, Inc.............3,243 shares

Total ....16,000 shares

Unsubscribed Capital Stock.................. 400,000.00

For 4,000 shares unsubscribed and unissued.

(4) **Treasury Stock** 100,000.00

To Working Capital 100,000.00

For capital stock donated to the Company as follows:

Smith Manufacturing Co....... 333 shares
Jones Manufacturing Co....... 334 shares
F. Macdonald, Inc............. 333 shares

Total ....1,000 shares

(5) **Cash** 400,000.00

To Unsubscribed Capital Stock............ 400,000.00

For 4,000 shares sold at par for cash.

(6) **Working Capital** 40,000.00

To Treasury Stock 40,000.00

For 400 shares of capital stock held in the treasury given as a bonus with the above sale of stock.

(7) **Sundries to Treasury Stock**		50,000.00
Cash	42,500.00	
Working Capital	7,500.00	

For 500 shares of capital stock held in the treasury sold at $85 per share. $15 discount per share charged to working capital.

Requirement 3.

Journal Entries to create Reserves for Depreciation and Bad Debts. Also to show the Declaration and Payment of a Six per cent Dividend.

(8) **Profit and Loss to Sundries**		$33,630.00	
To Reserve for Depreciation			28,400.00
8% on plant and machinery	$18,000.00		
1% on real estate and buildings	2,900.00		
15% on furniture and fixtures	3,300.00		
15% on horses and wagons	4,200.00		
To Reserve for Bad Debts			5,230.00
2% against accounts receivable.			
(9) **Profit and Loss**		156,370.00	
To Surplus			156,370.00

To transfer balance remaining in the former account, being net gain for the year after providing reserves as per preceding entry.

Requirement 4—Declaration of Dividend.

(10) **Surplus**	119,400.00	
To Dividend Account		119,400.00

For dividend of 6% declared by the Board of Directors on $1,990,000 of capital stock outstanding, payable forthwith.

(11) **Dividend Account**	119,400.00	
To Cash		119,400.00

For payment of above dividend in cash.

Requirement 5.

Balance Sheet as of December 31, 1909.

ASSETS.

Current Assets:		
Cash	$ 438,700.00	
Bills Receivable	31,000.00	
Accounts Receivable	261,500.00	
Loans Receivable	16,000.00	
Total	$ 747,200.00	
Inventories	261,500.00	
		$1,008,700.00

Fixed Assets:		
Real Estate and Buildings	$290,000.00	
Plant and Machinery	225,000.00	
Furniture and Fixtures	22,000.00	
Horses and Wagons	28,000.00	
		565,000.00
Goodwill		884,000.00
Treasury Stock		10,000.00
Total Assets		$2,467,700.00

LIABILITIES AND CAPITAL.

Current Liabilities:		
Bills Payable	$ 81,275.00	
Accounts Payable	94,100.00	
Bank Loans	14,500.00	
Mortgage Interest Payable	1,125.00	
		$ 191,000.00
Fixed Liabilities:		
Mortgage Payable		125,000.00
Reserves:		
Reserve for Depreciation	$ 50,900.00	
Reserve for Bad Debts	10,730.00	61,630.00
Total Liabilities		$ 377,630.00
Excess of Assets as follows:		
Capital Stock	$2,000,000.00	
Donated Surplus	52,500.00	
Surplus	37,570.00	2,090,070.00
Total Liabilities and Capital		$2,467,700.00

Requirement 6.

Determining Apportionment of Stock to Vendors.

The allotment of stock to vendors based on the net assets, plus capitalization of net profits after allowing 6% on investment, plus 1-3 unalloted stock to each.

Items.	Smith Mfg. Co.	Jones Mfg. Co.	F Macdonald Inc.	Combined.
Average Net Profits	$ 19,020.00	$ 47,400.00	$ 15,120.00	$ 81,540.00
Less 6% of Original Capital	7,500.00	18,000.00	9,000.00	34,500.00
Profits to be capitalized on a 6% basis	$ 11,520.00	$ 29,400.00	$ 6,120.00	$ 47,040.00
Goodwill, or Capitalized Profits	$192,000.00	$490,000.00	$102,000.00	$784,000.00
Add Net Assets	140,000.00	387,000.00	189,000.00	716,000.00
	$332,000.00	$877,000.00	$291,000.00	$1,500,000.00

Remaining 1,000 Shares, divided equally	33,300.00	33,400.00	33,300.00	100,000.00
Total	$365,300.00	$910,400.00	$324,300.00	$1,600,000.00

ADJUSTMENTS.

Problem No. 1.

THE FOLLOWING proposition is taken from the final examination of the Ontario Institute of Chartered Accountants, and is given as an excellent study in the adjustment of accounts and preparation of statements. The reader is advised to try his hand at working the problem before consulting the answer. Indeed this is the only way to derive any real benefit from it. In doing so a better insight can be gained by opening up the ledger accounts, so as to show in detail the adjustments and closing entries.

An inventory has been taken and the necessary entries made in the several accounts affected. In the course of the audit the items following the trial balance are found, which must be included in the accounts.

Trial Balance of a Sugar Manufacturing Concern on April 30, 1912.

Accounts receivable	$ 801.73	
Accounts payable		$ 24,875.70
Acreage, campaign 1911	3,154.33	
Beet accounts, campaign 1911	18,438.53	
Bills receivable	291.15	
Bills payable		133,600.00
Bonds		150,000.00
Capital stock		237,225.00
Buildings and plant	400,000.00	
Construction Co. (over-payment)	613.98	
Cooperage account, campaign 1911	952.11	
Coke, campaign 1911	379.30	
Chemicals, campaign 1911	327.67	
Coal, campaign 1911	10,369.49	
Electric plant	4,829.47	
Sugar and molasses on hand	32,800.31	
Inventory, supplies	5,164.74	
Filter cloth account, campaign 1911	705.07	
General expenses, campaign 1911	651.54	
Interest and discount, general	2,757.33	
Interest and discount, campaign 1911	1,224.25	
Insurance and taxes	162.45	
Legal account, general	916.64	
Limestone account, campaign 1911	599.93	
Profit and loss, April 30, 1911	68,781.42	
Oil, grease and waste, campaign 1911	193.34	
Cash on hand	92.17	

Cash in bank	1,666.18	
Real estate	3,429.20	
Subscribers (unpaid stock)	33,195.24	
Salary account, campaign 1911	697.65	
Sugar house supplies, campaign 1911	1,118.80	
Seed account, campaign 1911	1,196.70	
Loan from town council		25,000.00
Wages, campaign 1911	9,220.10	
Molasses, sales account		1,229.81
Sugar and molasses account		32,800.31
	$604,730.82	$604,730.82

Accounts payable, campaign 1911, $1,055.11; sums due from farmers for beet seed supplied during season of 1911, $1,000.00; sums due to farmers for beets supplied factory during same campaign, $15,625.03; sum due from Ontario Government as bounty on beets grown during campaign of 1911, $4,905.00; interest due and unpaid on bond issue, $5,500.00; interest due and unpaid on corporation loan, $624.25; provision for bad and doubtful accounts, $402.92; interest due and unpaid on loan for construction purposes, $750.00.

Stock subscription and charges appear in the Stock Ledger, amounting to $27,925, which have not been entered in the general ledger; of this amount $14,900 has been issued as bonus on shares sold and paid for. It is estimated that not more than $23,000 will be realized out of subscriptions, including the additions made above, and this asset in the statement of affairs is to be based on the realization as stated.

Interest is due to creditors upon extension notes given two years previous, $1,192.00; and it is found that an officer of the company has collected $275.00 in payment of the stock which he failed to account for; of this sum $261.60 is added to accounts receivable, and $13.40 is charged in the campaign of 1911 as general expenses.

From the information given above, make the adjusting entries necessary and prepare:

(a) Profit and Loss Account, divided as between "campaign 1911" and general profit and loss.

(b) Statement of Assets and Liabilities divided as between "available or cash assets" and "current or floating liabilities," and "permanent or fixed assets" and "bonded and capital liabilities."

(c) Impairment or Deficiency Account.

Note.—The accounts entering into earnings cover only one year previous, which in the beet sugar business is referred to as the "campaign."

SOLUTION

The proposition is not difficult, but involves so many different conditions that many who have attempted to work it have either been baffled or have erred in some particular point. It is not uncommon for the auditor to find upon investigation that several items have been omitted as shown above, either intentionally or otherwise, and it is his duty to be on the

watch at all times for such omissions. The ledger accounts should first be adjusted in accordance with the information presented by the auditor, and a new trial balance made to show the true condition of the accounts after the alterations are made. The following adjustment entries should be made and posted and a new trial balance presented:

Adjustment Entries.

(1)	Sundry expense, campaign 1911	$ 1,055.11	
	To accounts payable		$ 1,055.11
	For accounts not previously entered, specific distribution of which is not stated in question.		
(2)	Accounts receivable	1,000.00	
..	To seed accounts, campaign of 1911		1,000.00
	Due from farmers for seeds not previously charged, names of customers not mentioned in question.		
(3)	Beet account, campaign 1911	15,625.03	
	To accounts payable		15,625.03
	Due to farmers for beets received from them and not yet credited to their accounts, names not given.		
(4)	Ontario Government	4,905.00	
	To beets bounty, campaign 1911		4,905.00
	Bounty from Government earned but not yet entered.		
(5)	Bond interest	5,500.00	
	Town loan interest	624.25	
	Construction loan interest	750.00	
	Interest and discount, general	1,192.00	
	To interest payable		8,066.25
	Accrued interest on items shown, not yet entered.		
(6)	Profit and loss	402.92	
	To provision for bad debts		402.92
	Estimated loss in collecting accounts receivable.		

(7) The $275.00 collected by an officer of the Company and not accounted for has been charged to some account among the Accounts Receivable for $261.60, and 'General Expense, campaign 1911," for the remaining $13.40. The entry to be made now depends upon whether or not the said officer is to be found or worth this amount; if he is, he must be charged with the full amount, unless he was entitled to the $13.40, in which case he would only be charged with $261.60. Taking this view of it, his account would be debited and some other one of the Accounts Receivable credited, leaving the net result exactly as before. If he were not entitled to the $13.40 the entry would be:

Accounts Receivable (officer's account)........	$275.00	
To Accounts Receivable (account previously charged)		$261.60
To General Expense account............		13.40
or		
Accounts Receivable	13.40	
To General Expense account.............		13.40

Note.—We infer from the question that the amount paid was credited to Subscribers' Account at the time, and charged to some customer's account.

(8)	Subscribers (unpaid stock)..................	$13,025.00	
	Bonus	14,900.00	
	To Capital Stock.......................		$27,925.00
	Subscribed and bonus stock not previously entered up.		
(9)	Profit and loss............................	23,220.24	
	To provision for loss on subscriptions....		23,220.24
	Amount of estimated loss in realization.		

Note.—Since each subscriber for stock is liable for the full amount of his subscription, it would seem from the problem that some large provision for loss is considered.

Campaign Account, 1911.

Dr.			Cr.		
Acreage	$ 3,154.33		Campaign output:		
Beets	34,063.56		Sugar and molasses	$32,800.31	
Cost of seed	1,196.70		Molasses sales	1,229.81	
		$38,414.59	Seed sales	1,000.00	
Wages	9,220.10				$35,030.12
Chemicals	327.67		Beets' bounty		4,905.00
Coal	10,369.49				
Coke	379.30				$39,935.12
Limestone	599.93		Balance, loss on campaign, carried to Profit and Loss Account		26,122.88
Oil, grease, etc.	193.34				
Filter cloth	705.07				
Cooperage	952.11				
Sugar house supplies	1,118.80				
General expense	638.14				
Insurance and taxes	162.45				
Sundry expenses (owing)	1,055.11				
		25,721.51			
Salaries	697.65				
Interest and discount	1,224.25				
		1,921.90			
		$66,058.00			$66,058.00

Impairment and Deficiency Account.

Total impairment per Profit and Loss Account...	$145,167.68	Excess of current liabilities over available assets..	$138,276.35
		Excess of bonded and capital liabilities over fixed assets	6,891.33
	$145,167.68		$145,167.68

Note.—Sometimes bonus stock is carried as an asset and spread over a term of years. If this company were in good condition the bonus could be given a valuation, but the present outlook does not justify this.

Dr. Profit and Loss Account, April 30, 1912. Cr.

Loss campaign 1911, per campaign account		$26,122.88	Net loss for year ending April 30, 1912, carried forward	$38,266.02
General interest and discount		2,757.33		
Interest accrued:				
On bonds	$ 5,500.00			
On town loan	624.25			
On construction loans	750.00			
On extension notes	1,192.00			
		8,066.25		
Legal account		916.64		
Provision for bad debts		402.92		
		$38,266.02		$38,266.02
Net loss carried forward, April 30, 1911		68,781.42	Total net loss to date, being impairment of capital to this extent	$145,167.68
Net loss year ending April 30, 1912		38,266.02		
Bonus stock issued		14,900.00		
Provision for loss on realization of stock subscriptions		23,220.24		
		$145,167.68		$145,167.68

Statement of Assets and Liabilities, April 30, 1912.

ASSETS AVAILABLE:			CURRENT LIABILITIES:		
Accounts receivable:			Accounts payable:		
Trade	$ 815.13		Trade	$ 25,930.81	
Farmers	1,000.00		Farmers	15,625.03	
					$ 41,555.84
	$ 1,815.13		Bills payable		133,600.00
Less bad debts reserve	402.92		Accrued interest:		
		$ 1,412.21	On bond issue	5,500.00	
Bills receivable		291.15	On town loan	624.25	
Cash on hand	92.17		On construction loan	750.00	
Cash in bank	1,666.18		On extensions	1,192.00	
		1,758.35			8,066.25
Beets bounty—Ontario Government		4,905.00	Town loan		25,000.00
Supplies as per inventory		5,164.74			
Sugar and molasses on hand		32,800.31			
Construction Co., overpayment		613.98			
Unpaid stock	46,220.24				
Less prov. on realization for loss	23,220.24				
		23,000.00			

Balance: Excess of current liabilities over available assets	138,276.35		
	$208,222.09		$208,222.09
FIXED ASSETS:		BONDED AND CAPITAL LIABILITIES:	
Buildings and plant	$400,000.00	Bonds outstanding	$150,000.00
Electric plant	4,829.47	Capital stock	265,150.00
Real estate	3,429.20		
	$408,258.67		
Balance: Excess of bonded and capital liabilities over fixed assets	6,891.33		
	$415,150.00		$415,150.00

Problem No. 2.

Smith, Hill and Davis engage in business under an agreement that Smith is to have a salary of $200.00; Hill $150.00, and Davis $100.00 per month, respectively; that the earnings are to be determined at any time at the request of any partner and the profits divided on a basis of the amount of business secured by each. They are in business nine months and find their accounts as follows:

Smith's business	$4,500.00
Hill's business	2,800.00
Davis' business	3,000.00
Net profits	2,100.00

They then decide to rescind the salary agreement and divide the profits shown on a basis of business secured individually, treating the salary drawn as an advance.

You find errors during the nine months' period, namely:

Office furniture, charged to operation	$ 65.00
Accounts receivable, Smith's business uncollectable	210.00
Funds advanced by Davis, credited to his earning account	400.00

Items not yet paid nor entered into accounts:

Smith's salary	$200.00
Hill's salary	150.00
Advertising	27.50
Clerk hire	130.00
Telephone	6.00
Rent	50.00
Stationery expenses	15.00

Show the journal entries necessary to readjust the accounts; making a statement of the profit and loss account, showing all corrections.

SOLUTION

This question calls for some careful thought in order to make the adjustments required, as well as close inspection, to interpret its requirements. We note that the partnership agreement pertaining to the divi-

sion of profits and handling of salaries was rescinded after a period of nine months. This is taken to mean that the former agreement on this point was made void and disregarded, therefore the division of profits for said period is made according to the new agreement. On this basis the salaries of partners, amounting to $3,700, must be deducted from the business expenses and charged against their personal accounts. The salaries still due Smith and Hill are omitted from consideration, since they have not yet been taken out.

Adjusting entries are required as shown below for office furniture, uncollectable accounts, and funds advanced by Davis. The $400 advanced by Davis being adjusted from earnings to his personal account, thereby reducing his business earnings to $2,600. The uncollectable accounts are charged as a loss to the business rather than to Smith personally, on the presumption that said business was transacted in good faith by him as a member of the firm. The net results would, of course, be changed somewhat if an opposite view were taken. The net profit of $2,100 shown in this question requires some analysis as herein shown for the purpose of presenting a true exhibit of the operating expenses. Expense items outstanding are adjusted into the profit and loss account and credited as liabilities to the various accounts stated, instead of including them all in expense account. We are asked to show the adjustment entries and the profit and loss statement, also the personal accounts of partners showing all corrections. In making the adjustments and statements the changes are shown on the presumption that the books have not yet been closed. If the ledger accounts had already been closed and profits apportioned, the adjustments would necessarily be made through an adjustment account and into the partners' accounts, instead of through profit and loss account.

Adjusting Entries.

Entry 1.	Office furniture	$ 65.00	
	To operating expenses..................		$ 65.00
	For transfer from operating expenses to fixtures account.		
Entry 2.	Profit and loss..........................	210.00	
	To accounts receivable..................		210.00
	For accounts of Smith's business uncollectable.		
Entry 3.	Davis' business	400.00	
	To Davis personal.....................		400.00
	For loan by Davis wrongly credited to his business account.		
Entry 4.	Smith personal	1,600.00	
	Hill personal	1,200.00	
	Davis personal	900.00	
	To salaries		3,700.00
	For transfer of paid salaries from salaries account to personal accounts of partners, per new agreement.		

Entry 5.	Profit and loss	4,435.00	
	To operating expenses		4,435.00
	For transfer of paid expenses to profit and loss account.		
Entry 6.	Profit and loss	228.50	
	To advertising payable		27.50
	To clerk hire		130.00
	To telephone expense payable		6.00
	To rent payable		50.00
	To stationery expense payable		15.00
	For expense items accrued or owing but not yet entered into the accounts.		
Entry 7.	Smith's business	4,500.00	
	Hill's business	2,800.00	
	Davis' business	2,600.00	
	To profit and loss		9,900.00
	For transfer of earnings to profit and loss account.		
Entry 8.	Profit and loss	5,026.50	
	To Smith personal		2,284.77
	To Hill personal		1,421.64
	To Davis personal		1,320.09

Note.—In case the ledger has already been closed the journal entries would be changed considerably and an adjustment account opened.

Smith's Personal Account.

Drawings	$1,600.00	Net profit	$2,284.77
Balance	684.77		
	$2,284.77		$2,284.77
		Balance	$ 684.77

Hill's Personal Account.

Drawings	$1,200.00	Net profit	$1,421.64
Balance	221.64		
	$1,421.64		$1,421.64
		Balance	$ 221.64

Davis' Personal Account.

Drawings	$ 900.00	Cash loan	$ 400.00
	820.09	Net profit	1,320.09
	$1,720.09		$1,720.09
		Balance	$ 820.09

Profit and Loss Statement for Nine Months.

Earnings.

Smith's business, credited		$4,500.00
Hill's business, credited		2,800.00
Davis' business, credited	$3,000.00	
Less loans advanced	400.00	
		2,600.00
Total business earnings		$9,900.00

Operating Expenses.

Expenses, etc., paid		$4,500.00	
Partners' salaries paid		3,700.00	
Total operating expenses paid		$8,200.00	
Deduct partners' salaries	$3,700.00		
Deduct office furniture	65.00		
		3,765.00	
Expenses allowed		$4,435.00	
Add expenses not entered:—			
Advertising		27.50	
Clerk hire		130.00	
Telephone charges		6.00	
Rent		50.00	
Stationery expenses		15.00	
Accounts uncollectable		210.00	
Total expenses and charges			4,873.50
Net profit for period			$5,026.50

Profits Apportioned to

Smith	45-99	$2,284.77
Hill	28-99	1,421.64
Davis	26-99	1,320.09
Total		$5,026.50

Note.—If the ledger has already been closed, and an adjustment of profit and loss statement required, such adjustments could be made by use of parallel columns in the statement.

MANUFACTURING AND TRADING ACCOUNTS.

Problem No. 1.

THE FOLLOWING figures are taken from the books of the Fairview Manufacturing Company, on the 31st of December:

Inventory of Finished Goods (Jan. 1)	$ 3,684.57
Inventory of Raw Material (Jan. 1)	11,392.70
Purchase of Raw Materials	62,519.85
Sales	217,387.42
Wages	109,317.88
Rent	19,500.00
Discounts received on Purchases	375.60
Discounts allowed on Sales	186.36
Power, Light and Heat	8,710.64
Light and Heat for Office	168.00
Repairs	1,090.00
Packing	2,017.00
Factory Expense	3,270.00

General Expense	5,230.00
Factory Insurance	1,050.00
General Insurance	750.00
Machinery and Plant	12,350.00
Tools	2,600.00
Commissions	7,642.00
Office Salaries	9,700.00
Interest on Loans	8,930.00
Salesmen Salaries	440.00
Loans Payable	22,000.00
Discount Lost	120.00
Notes Receivable	130,000.00
Notes Receivable Discounted	8,000.00
Notes Payable	19,500.00
Accounts Receivable	101,026.00
Accounts Payable	30,020.00
Office Furniture	1,100.00
Furniture and Fixtures	1,950.00
Cash on Hand	1,825.00
Cash in Banks	26,467.00
Returned Sales	276.00
Capital	200,000.00
Reserve for Depreciations	3,236.98
Reserve for Bad Debts	5,727.00
Freight and Cartage Inward	727.00
Stable Expenses	2,750.00
Horses, Wagons and Harnesses	8,500.00
Postage and Expressage	1,250.00
Superintendence	3,500.00
Taxes	250.00
Goodwill	10,000.00
Stationery and Printing	1,080.00
Advertising	8,630.00
Surplus (previous year)	63,753.00

You are requested (a) to prepare from these a Trial Balance, arranged in systematic order as to Balance Sheet Accounts, Assets and Liabilities and Loss and Gain Accounts, Expenses and Revenues, the Expenses divided between Commercial and Manufacturing, so as to facilitate the preparation of Financial or Business Statements; (b) to draft journal entries for closing books; (c) to prepare Manufacturing, Trading and Profit and Loss accounts and (d) to verify your results shown in (c) by a Balance Sheet. The following inventories and adjustments are to be taken into consideration before preparing the statements asked for:

Raw Material	$16,250.00
Finished Goods	9,386.00
Tools	2,000.00
Office Furniture	1,000.00
Furniture and Fixtures	1,500.00
Stationery and Printing	300.00

Allow for depreciations:

On Machinery and Plant 5 per cent.

On Horses, Wagons and Harnesses 10 per cent.

Reserve for Bad Debts 3 per cent on Accounts Receivable only.

The item of Rent $19,500 is to be apportioned as follows: 53 per cent for Factory, 22 per cent for Salesrooms, and 25 per cent for Office.

The item of Superintendence $3,500 is to be divided 3-5 to Factory, and 2-5 to general expense.

Comments.

This problem presents many interesting points, and, no doubt, was designed to test the applicant's ability in charting and planning the ledger accounts, as well as in setting forth the required information in suitable business statements. There is usually too much disregard, on the part of bookkeepers, for the systematic arrangement of ledger accounts, and in many cases the ledger represents a jumbled up mass of accounts opened on ledger pages regardless of location, space required, classification or logical division. Before the ledger is opened, care should be taken in planning the order in which the accounts should be shown therein, and the number of pages to be allotted to each. Accounts that are likely to require two or more pages during the currency of the ledger, should be given sufficient space to accommodate the records of said accounts without having to be transferred to another part of the ledger.

The arrangement of accounts as shown in the trial balance, is so conveniently planned that the usual statements can be made up with very little effort. The location of accounts may not be satisfactory to some accountants, and the division may not please in all cases, but that is immaterial so long as the object is reached and satisfactory results attained. This order of arrangement, however, has considerable merit and is worthy of adoption, though any other convenient plan may suit just as well.

The ledger accounts begin with the assets, arranged in the order shown herein, and listed according to availability in case of realization. Cash is first because it is available and ready for use at any time. Accounts and notes of customers come next, since they are most readily converted into cash. The liabilities follow, and are arranged in the order in which they will rank in the matter of payment or liquidation. Notes and accounts are usually first demands, and capital stock the very last. Following these, we have the expense accounts divided as among manufacturing, selling and general. These divisions will greatly facilitate the preparation of business and financial statements and are advisable where a great number of accounts are required. The expense accounts may be arranged in alphabetical order, as shown under the section of general expenses. As a rule, several pages are left blank in each section for any additional accounts that may be required during the course of business. For instance, Cash would appear on page 1, and Goodwill on page 20; then, skipping a few pages, Notes Payable would follow on page 31. The expense or operating accounts may then begin on page 51, and so on. For convenience, the sections are often given 100 pages each, in which case the manufacturing account shown herein would be on page 51 or 101, according to the plan fol-

lowed. In the use of modern loose leaf and card ledgers of course these suggestions may be disregarded.

It will be noticed that the information contained in the balance sheet is subdivided under appropriate headings. This plan might be followed in the revenue statements also if thought advisable, and in many cases such divisions are preferable, as they enable the unskilled person to comprehend the statements more readily without being required to analyze for himself. This matter of sub-dividing, however, is too often overdone and therefore should not be used too freely where unnecessary.

(a) Trial Balance, December 31.

Assets.		
Cash on hand	$ 1,825.00	
Cash in bank	26,467.00	
Notes receivable, (per schedule)	130,000.00	
Accounts receivable, (per schedule)	101,026.00	
Inventory of finished goods, Jan. 1	3,684.57	
Inventory of raw material, Jan. 1	11,392.70	
Tools	2,600.00	
Furniture and fixtures	1,950.00	
Office furniture	1,100.00	
Horses, wagons and harnesses	8,500.00	
Machinery and Plant	12,350.00	
Goodwill	10,000.00	
Liabilities.		
Notes payable, (per schedule)		$ 19,500.00
Notes receivable, discounted, (per schedule)		8,000.00
Accounts payable, (per schedule)		30,020.00
Loans payable, (per schedule)		22,000.00
Reserve for depreciations		3,236.98
Reserve for bad debts		5,727.00
Surplus, previous year		63,753.00
Capital		200,000.00
Revenues.		
Sales		217,387.42
Discounts received on purchases		375.60
Manufacturing Expenses.		
Purchases, raw material	62,519.85	
Freight and cartage inward	727.00	
Wages	109,317.88	
Power, light and heat	8,710.64	
Factory expenses	3,270.00	
Factory insurance	1,050.00	
Superintendence, factory,	2,100.00	
Repairs	1,090.00	
Rent of factory	10,335.00	

Commercial Expenses.

Advertising	8,630.00	
Salesmen's salaries	8,930.00	
Commissions	7,642.00	
Returned sales	276.00	
Discount on sales	186.36	
Packing	2,017.00	
Rent of salesrooms	4,290.00	
Stable expenses	2,750.00	

General Expenses.

Discount lost	120.00	
General expense	5,230.00	
General insurance	750.00	
Interest on loans	440.00	
Light and heat, office	168.00	
Office salaries	9,700.00	
Postage and expressage	1,250.00	
Rent for office	4,875.00	
Superintendence, general	1,400.00	
Stationery and printing	1,080.00	
Taxes	250.00	
Total	$570,000.00	$570,000.00

(b) Journal Entries.

Manufacturing Account	$ 62,519.85	
To Purchases		$ 62,519.85
Manufacturing Account	137,818.02	
To Freight Inward		727.00
Wages		109,317.88
Power, light, heat		8,710.64
Factory expenses		3,270.00
Factory insurance		1,050.00
Superintendence		2,100.00
Rent, factory,		10,335.00
Repairs		1,090.00
Reserve for depreciation		617.50
Tools Account		600.00
Trading Account	195,480.57	
To Manufacturing Account		195,480.57
Sales Account	276.00	
To Returned Sales		276.00
Sales Account	217,111.42	
To Trading Account		217,111.42
Trading Account	35,295.36	
To Advertising		8,630.00
Salesmen's salaries		8,930.00
Commissions		7,642.00

Discount on Sales		186.36
Packing		2,017.00
Rent of Salesrooms		4,290.00
Stable Expenses		2,750.00
Reserve for Depreciation		850.00
Loss and Gain	7,963.08	
To Trading Account		7,963.08
Discount on Purchases	375.60	
To Manufacturing Account		375.60
Loss and Gain	28,543.78	
To Discount Lost		120.00
General Expense		5,230.00
General Insurance		750.00
Interest on Loans		440.00
Light and Heat		168.00
Office Salaries		9,700.00
Postage and Expressage		1,250.00
Rent		4,875.00
Superintendence		1,400.00
Stationery and Printing		780.00
Taxes		250.00
Office Furniture		100.00
Furniture and Fixtures		450.00
Reserve for Bad Debts		3,030.78
Surplus Account	36,131.26	
To Loss and Gain		36,131.26

Note.—To save space, explanations are omitted, also entries dealing with inventories.

(c) Manufacturing Account, Dec. 31.

Debits.			Credits.	
Inventory raw material Jan. 1		$ 11,392.70	Cost of goods manufactured, carried to Trading Account	$195,104.97
Purchases raw material		62,519.85		
Freight inward		727.00		
		74,639.55		
Deduct:				
Discount on purchases	$ 375.60			
Raw material on hand	16,250.00	$ 16,625.60		
Material consumed		58,013.95		
Wages		109,317.88		
Power, light and heat		8,710.64		
Factory expenses		3,270.00		
Factory insurance		1,050.00		
Superintendence, factory		2,100.00		
Rent of factory		10,335.00		
Repairs		1,090.00		
Depreciation:				
On machinery and plant 5%		617.50		
On tools		600.00		
		$195,104.97		$195,104.97

Trading Account.

Debits.		Credits.	
Inventory finished goods Jan. 1	$ 3,684.57	Sales for year	$217,387.42
Manufactured during year	195,104.97	Less returns	276.00
Total	198,789.54	Net Sales	217,111.42
Deduct:		Balance, Loss, carried to Loss and Gain Account	7,587.48
Finished goods on hand	9,386.00		
Cost of goods sold	189,403.54		
Advertising	8,630.00		
Salesmen's salaries	8,930.00		
Commissions	7,642.00		
Discounts on sales	186.36		
Packing	2,017.00		
Rent of salesrooms	4,290.00		
Stable expenses	2,750.00		
Depreciation:			
Horses, wagons and harness	850.00		
	$224,698.90		$224,698.90

Loss and Gain Account.

Debits.			Credits.	
Loss from trading as shown by Trading Account		$ 7,587.48	Balance, Net Loss carried to the debit of Surplus account	$ 36,131.26
Discount lost		120.00		
General expense		5,230.00		
General insurance		750.00		
Interest on loans		440.00		
Light and heat, office		168.00		
Office salaries		9,700.00		
Postage and expressage		1,250.00		
Rent for office		4,875.00		
Superintendence, general		1,400.00		
Stationery and printing	$1,080.00			
Less inventory	300.00	780.00		
Taxes		250.00		
Depreciation of:				
Office furniture		100.00		
Furniture and fixtures		450.00		
Reserve for bad debts, 3% on accounts receivable		3,030.78		
		$ 36,131.26		$36,131.26

(d) Balance Sheet, Dec. 31.

Current Assets.			**Current Liabilities.**		
Cash on hand	$ 1,825.00		Notes payable (per schedule)	$ 19,500.00	
Cash in bank	26,467.00	$ 28,292.00	Accounts payable (per schedule)	30,020.00	49,520.00
Notes receivable	130,000.00		Loans payable		22,000.00
Less notes under discount	8,000.00		**Reserve Accounts.**		
	$122,000.00		For depreciation	3,236.98	
Accounts receivable (per schedule)	101,026.00	223,026.00	On horses, wagons, and harness 10%	850.00	
			On machinery and plant 5%	617.50	4,704.48

Raw material on hand	16,250.00		For bad debts	5,727.00	
Finished goods on hand	9,386.00	25,636.00	On accounts receivable, 3%	3,030.78	8,757.78
Personal Property.			**Fixed Liabilities.**		
Tools in factory	2,600.00		Surplus	63,753.00	
Less depreciation	600.00	2,000.00	Less net loss	36,131.26	27,621.74
Furniture and fixtures	1,950.00		Capital Stock		200,000.00
Less depreciation	450.00	1,500.00			
Office furniture	1,100.00				
Less depreciation	100.00	1,000.00			
Stationery and supplies		300.00			
Fixed Assets.					
Horses, wagons and harness		8,500.00			
Machinery and plant		12,350.00			
Total tangible assets		302,604.00			
Good will		10,000.00			
		$312,604.00			$312,604.00

Problem No. 2.

The following figures are taken from the books of Johnson Mill Company on December 31, after they had operated for one year. You are requested to prepare:

(a) Trial Balance.
(b) Manufacturing Account.
(c) Trading Account.
(d) Profit and Loss Account.
(e) Balance Sheet.
(f) Draft resolution for directors to pass, declaring dividend, retaining 10 per cent of net profits as a reserve, make journal entries for dividend and reserve.

Yarn (used	$25,000.00
Sales	81,250.00
Wages	22,500.00
Discounts received	2,500.00
Dyeing	12,500.00
Power, light and heat	3,125.00
Boxes and cases	1,250.00
Repairs	685.00
Sundry expenses (mills)	1,060.00
Insurance	155.00
Salaries	2,500.00
Taxes	310.00
Depreciation	425.00
Advertising	1,250.00
Traveling expenses	1,125.00

Returns	1,000.00
Commissions	1,875.00
Discounts allowed by us	440.00
Interest on loans	410.00
Cash at bank and in hand	14,065.00
Bills payable	37,500.00
Sundry debtors	22,500.00
Sundry creditors	6,250.00
Fixtures and fittings, office	4,750.00
Capital	93,750.00
Machinery and plant	65,925.00
Bills receivable	38,400.00

Comments.

This question is one of two which were required by the Maryland C. P. A. board to be answered during one sitting of three and one-half hours, and is probably the easiest of all the questions on the Practical Accounting papers. One can judge from this that the Maryland examination questions are up to the standard of thoroughness and practicability. The question should be studied carefully by the student of accountancy because it presents a few interesting points that are likely to be overlooked upon first attempt at solution and the answer should not be consulted until a solution is provided according to his own ideas.

It will be noticed that no inventories are mentioned and that no specific allowances for accounts and bills receivable are made. Under the circumstances no notice of them is taken, but in actual cases a consideration of them is usually imperative and arbitrary amounts could be assumed by the student for the solution of such an exercise. Depreciation is given as a debit balance of $425.00. This is no doubt on plant and machinery and is therefore charged to manufacturing, but the amount is entirely too low if it is considered as a yearly allowance on the property. It is presumed to have been credited to the account from which it was allowed. Repairs, insurance and taxes are also placed in the manufacturing account, as they were no doubt expended on machinery and plant. Boxes and cases are supposed to have been used in preparing goods for shipment and are therefore a charge to trading account. Discounts on both purchases and sales are entered in the profit and loss account, but they can also properly be considered in the trading section.

A reserve of 10 per cent is set aside, and $1,701.00 is carried to undivided profits account. This makes an even amount, $5,625.00, for a 6 per cent dividend, otherwise the dividend account would contain an uneven amount. This, however, is simply one view of the matter and not necessarily that of the examiners. The resolution of the directors declaring the divided would appear in the minute book.

Answer.

(a) Trial Balance, Dec. 31.

Yarn (used)	$ 25,000.00	
Sales		$ 81,250.00

Wages	22,500.00	
Discounts received		2,500.00
Dyeing	12,500.00	
Power, light and heat	3,125.00	
Boxes and cases	1,250.00	
Repairs	685.00	
Sundry expenses (mills)	1,060.00	
Insurance	155.00	
Salaries	2,500.00	
Taxes	310.00	
Depreciation	425.00	
Advertising	1,250.00	
Traveling expenses	1,125.00	
Returns	1,000.00	
Commissions	1,875.00	
Discounts allowed	440.00	
Interest on loans	410.00	
Cash	14,065.00	
Bills payable		37,500.00
Sundry debtors	22,500.00	
Sundry creditors		6,250.00
Fixtures and fittings, office	4,750.00	
Capital		93,750.00
Machinery and plant	65,925.00	
Bills receivable	38,400.00	
	$221,250.00	$221,250.00

(b) Manufacturing Account, Dec. 31.

Costs.		Proceeds.	
Yarn (used)	$ 25,000.00	Balance, cost of manufacturing charged to Trading Account	$ 65,760.00
Wages	22,500.00		
Dyeing	12,500.00		
Power, light and heat	3,125.00		
Mill expenses	1,060.00		
Repairs	685.00		
Insurance	155.00		
Taxes	310.00		
Depreciation	425.00		
	$ 65,760.00		$ 65,760.00

(c) Trading Account, Dec. 31.

Charges.		Sales.	
Balance from Manufacturing Account, cost of goods	$ 65,760.00	Sales	$ 81,250.00
Boxes and cases	1,250.00	Less returns	1,000.00
Traveling expenses	1,125.00	Net sales	$ 80,250.00
Commissions	1,875.00		
Total charges	$ 70,010.00		
Gross gain, carried to Profit and Loss Account	10,240.00		
	$ 80,250.00		$ 80,250.00

(d) Profit and Loss Account, Dec. 31.

Debits.		Credits.	
Salaries	$ 2,500.00	Gross gain from Trading Account	$ 10,240.00
Advertising	1,250.00	Discounts received	2,500.00
Discounts allowed	440.00		
Interest on loans	410.00		
Total debits	$ 4,600.00		
Net profit, carried down	8,140.00		
	$ 12,740.00		12,740.00
Reserve	814.00	Net profit, brought down	8,140.00
Dividend 6%	5,625.00		
Undivided profits	1,701.00		
	$ 8,140.00		$ 8,140.00

(e) Balance Sheet, Dec. 31.

Assets.		Liabilities.		
Cash	$ 14,065.00	Bills payable		$ 37,500.00
Sundry debtors	22,500.00	Sundry creditors		6,250.00
Bills receivable	38,400.00			
Office fixtures	4,750.00	Total liabilities		$ 43,750.00
Machinery and plant	65,925.00	Capital stock		93,750.00
		Dividend	$5,625.00	
		Reserve	814.00	
		Undivided profits	1,701.00	8,140.00
	$145,640.00			$145,640.00

(f) Resolution Declaring Dividend.

Resolved, that a dividend of six (6) per cent from surplus profits be and hereby is declared upon the capital stock of the company, payable on the 25th day of January, to the stockholders of record as shown by the books of the company on the 15th day of January, and that the treasurer of the company be and is hereby authorized and directed to pay said dividend in accordance with the terms of the present resolution.

Journal Entries.

Profit and Loss	$8,140.00	
To Reserve		$ 814.00
To Dividend		5,625.00
To Undivided Profits		1,701.00

Disposition of net profits as per resolution of the board of directors.

Note.—The remaining profits are usually disposed of also by resolution or motion of the directors, and may, if desired, be incorporated in the above resolution.

BLAST FURNACE RECORDS.

From the following Trial Balance and information furnished, draw up—(1) A Cost Sheet; (2) A statement of Profits and Income; and (3) A Balance Sheet, showing also such intermediary accounts (if any) as may be necessary to connect—(a) The Cost Sheet with the Statement of Profits and Income; (b) The Statement of Profits and Income with the Balance Sheet.

Trial Balance—December 30, 1911.

Real Estate	$ 200,000.00	
Buildings	500,000.00	
Furnaces, Plant and Equipment	1,400,000.00	
Capital Stock authorized		$1,000,000.00
Stock Subscriptions unpaid	200,000.00	
Stock in Treasury	50,000.00	
5 per cent First Mortgage Gold Bonds due December 30, 1921, authorized		500,000.00
5 per cent First Mortgage Gold Bonds Redeemed	100,000.00	
Purchase Money Obligations		200,000.00
Ore, 248,620 Tons at $2.50 per Ton	621,550.00	
Advances on Ore Contract	50,000.00	
Coke, 211,400 Tons, at $3.25 per Ton	687,050.00	
Limestone, 45,900 Tons at $1.00 per Ton	45,900.00	
Supply Stores on hand Dec. 30, 1911	25,000.00	
Customers' Accounts	350,110.00	
Bills Receivable	50,000.00	
Sundry Debtors	10,000.00	
Bills Payable		350,000.00
Accounts Payable		310,000.00
Reserve for Bad Debts		12,000.00
Cash in Bank	235,000.00	
Working Funds	5,000.00	
Depreciation Reserve		115,000.00
Blast Furnace Relining Fund		45,000.00
Pig Iron on hand June 1, 1911 (6,500 Tons)	97,500.00	
Discount on Bonds	20,000.00	
Exploration and Development Expenditures	17,500.00	
Surplus January 1, 1911		583,887.00
Furnace Labor	138,750.00	
Handling and delivering ore to ore stock	24,862.00	
Handling and delivering coke to coke stock	10,570.00	
Handling and delivering limestone to limestone stock	2,245.00	
Repairs and Maintenance	15,500.00	
Electric Light and Power	9,500.00	
Blowing	10,000.00	
Laboratory Expense	4,000.00	

Yard and Switching Expense	14,200.00	
General Works Expense	19,750.00	
Taxes	5,200.00	
Insurance	7,800.00	
Pig Iron Sales (109,500 Tons)		1,971,000.00
Allowances to Customers	54,500.00	
Salesmen's Salaries and Commissions	50,900.00	
Traveling Expenses	2,500.00	
Stationery and Office Expenses	4,500.00	
General and Administration Expenses	15,000.00	
Profit on sale of purchased Pig Iron		25,500.00
Miscellaneous Income		17,500.00
Interest on Bonded Debt	15,000.00	
Interest on Bills Payable	22,000.00	
Expenditures incurred on account Relining Blast Furnace	38,500.00	
	$5,129,887.00	$5,129,887.00

The production of Pig Iron for the year was 115,000 Tons, and the Materials consumed or used to obtain this production were:

Ore	240,000 Tons
Coke	210,000 Tons
Limestone	40,000 Tons

The Bond Interest Accrued and not taken upon the books was $5,000.00, while Interest amounting to $4,000.00 on Bills Payable was paid in advance. There was $5,000.00 of Furnace Labor Accrued but not paid. The Taxes accrued but not taken upon the books were $2,300.00, exclusive of Federal Corporation Tax, which should be provided for, and Insurance Premiums paid in advance amounted to $1,800.00. A provision of 15c per ton of production should be made for Relining Furnaces; and the Directors authorized a further provision for General Depreciation of Buildings, Plant and Equipment of $50,000.00. The Discount on Bonds should be absorbed over the life of the Bonds and one-fifth proportion should be written off the Exploration and Development Expenditures.

In calculating the Cost Units, you need not figure beyond two places of decimals; and in making these calculations the Operating Expenses (as distinct from Materials) may be grouped into two classes, viz.: (1) Labor; and (2) All other Operating Expenses. All other unit costs may be ignored.

Cost Sheet. Production of Pig Iron, 115,000 Tons.

Materials Used:	Total Cost	Cost per Ton
Ore, 240,000 tons at $2.60	$ 624,000.00	$ 5.43
Coke, 210,000 tons at $3.30	693,000.00	6.03
Limestone, 40,000 tons at $1.05—	41,950.00	.36
Total Cost Materials	$1,358,950.00	$11.82

Labor Charges:		
Furnace Labor	143,750.00	1.25
Cost Labor and Materials	$1,502,700.00	$13.07
Operating Expenses:		
Relining Blast Furnace	$ 17,250.00	
Depreciation of Building, Plant, Equipment	50,000.00	
Repairs and Maintenance	15,500.00	
Electric Light and Power	9,500.00	
Blowing	10,000.00	
Laboratory Expense	4,000.00	
Yard and Switching Expenses	14,200.00	
General Works Expenses	19,750.00	
Taxes	7,500.00	
Insurance	6,000.00	
	$ 153,700.00	1.33
Total	$1,656,400.00	$14.40

Statement of Profits and Income for the Current year Ended Dec. 30, 1911.

Income.

Sales for Year:		
Pig Iron Manufactured, 109,500 Tons at $18.00	$1,971,000.00	
Less Allowances to Customers	54,500.00	
Net Sales		$1,916,500.00
Operating Charges:		
Inventory Pig Iron Jan. 1, 1911	$ 97,500.00	
Manufactured cost of 115,000 tons Pig Iron per production cost sheet at $15	1,656,400.00	
	$1,753,900.00	
Less Inventory Dec. 30, 1911, 1,200 tons at $15.00	180,000.00	
First cost of sales	$1,573,900.00	
Salesmen's salaries and commissions	50,900.00	
Traveling expenses	2,500.00	
Stationery and office expenses	4,500.00	
General and administrative expenses	15,000.00	
Total operating charges		1,646,800.00
Net operating profit for 1911		$ 269,700.00

General Income and Expenses:		
Add profit on sales of purchased Pig Iron..$	25,500.00	
Add miscellaneous income................	17,500.00	43,000.00
Profit on Operating and Miscellaneous.		$ 312,700.00
Deduct:		
Discount on bonds 1/10 of $20,000........$	2,000.00	
Exploration and development expenditures, 1/5 written off......................	3,500.00	
Interest on bonded debt..................	20,000.00	
Interest on bills payable..................	18,000.00	
Federal Corp. tax........................	2,642.00	46,142.00
Net profit for 1911..................		$ 266,558.00

Note.—Pig Iron is inventoried at $15.00 per ton, the production cost being $14.40. This gives an apparent profit of $7,200, but is in harmony with the policy already established, as seen by the inventory listed at the beginning of the year.

Balance Sheet, December 30, 1911.

ASSETS.

Fixed Assets:		
Real estate ....$	200,000.00	
Buildings	500,000.00	
Furnaces, plant and equipment............	1,400,000.00	$2,100,000.00
Inventory:		
Ore, 8,620 tons at $2.60..................$	22,412.00	
Coke, 1,400 tons at $3.30.................	4,620.00	
Limestone, 5,900 tons at $1.05............	6,195.00	
Pig Iron, 12,000 tons at $15.00...........	180,000.00	
Supply stores	25,000.00	238,227.00
Current Assets:		
Cash in bank............................$	235,000.00	
Working funds	5,000.00	
Bills receivable	50,000.00	
Customers' accounts	350,110.00	
Sundry debtors	10,000.00	650,110.00
Advance on Ore contracts...................		50,000.00
Deferred Charges to Profit and Income:		
Discount on bonds......................$	18,000.00	
Exploration and development expenditures	14,000.00	32,000.00
Prepaid Interest:		
Interest on bills payable advanced.........$	4,000.00	
Insurance premiums advanced............	1,800.00	5,800.00
Total Assets		$3,076,137.00

LIABILITIES AND CAPITAL.

Bonded Debt:			
Purchase money obligations			$ 200,000.00
First mortgage, 5% bonds		$ 500,000.00	
Less bonds redeemed		100,000.00	400,000.00
Current Liabilities:			
Bills payable		$ 350,000.00	
Accounts payable		310,000.00	
Bonds interest, due		5,000.00	
Furnace labor, accrued		5,000.00	
Taxes accrued, unpaid		2,300.00	
Federal corporation tax		2,642.00	674,942.00
Total Liabilities			$1,274,942.00
Reserve Accounts:			
For bad debts		$ 12,000.00	
For depreciation		165,000.00	
Relining blast furnace		23,750.00	200,750.00
Capital and Surplus:			
Capital stock authorized		$1,000,000.00	
Less stock in treasury	50,000.00		
Less subscriptions unpaid	$ 200,000.00	250,000.00	750,000.00
Surplus Jan. 1, 1911		$ 583,887.00	
Net profit for 1911		266,558.00	850,445.00
			$3,076,137.00

Inventory Valuations and Surplus, December 30, 1911.

Ore Account.

Purchased during year	248,620	tons at $2.50	$ 621,550.00
Handling to stock pile, 10 cents per ton			24,862.00
Total cost in stock pile	248,620	tons at $2.60	$ 646,412.00
Used in manufacturing during year	240,000	tons at $2.60	624,000.00
On hand in stock pile	8,620	tons at $2.60	$ 22,412.00

Coke Account.

Purchased during year	211,400	tons at $3.25	$ 687,050.00
Handling to stock pile, 5 cents per ton			10,570.00
Total cost in stock pile	211,400	tons at $3.30	$ 697,620.00
Used in manufacturing during year	210,000	tons at $3.30	693,000.00
On hand in stock pile	1,400	tons at $3.30	$ 4,620.00

Limestone Account.

Purchased during year	45,900	tons at $1.00	$ 45,900.00
Handling to stock pile, 5 cents per ton			2,245.00
Total cost in stock pile	45,900	tons at $1.05	$ 48,145.00
Used in manufacturing during year	40,000	tons at $1.05	41,950.00
On hand in stock pile	5,900	tons at $1.05	$ 6,195.00

Pig Iron Account.

On hand January 1st	6,500	tons at $15.00	$ 97,500.00
Manufactured during year	115,000	tons at $14.40	1,656,450.00
Total	121,500	tons	$1,753,950.00
Sales	6,500	tons at $15.00	97,500.00
Sales	103,000	tons at $14.40	1,483,650.00
Total sales	109,500	tons	$1,581,150.00
On hand December 31st	12,000	tons at $14.40	$ 172,800.00
Add increase from $14.40 per ton to $15.00			7,200.00
		Inventory valuation	$ 180,000.00

Assumed Tonnage, Cost and Selling Price of "Bought" Pig Iron.

10,200 tons at $18.00 per ton	$ 183,600.00
Cost at $15.50	158,100.00
Profit on sales as per problem	$ 25,500.00

Answer and Comments.

This is one of five questions given on the recent Illinois C. P. A. Examination. They were all to be completed within three hours, thus indicating that this one had a time limit of one and one-half hours or less. The time limit seems short for questions of this kind, yet it is another reminder to candidates that the matter of time is of great importance when writing on examinations. Practice in answering questions within limited time is a necessity for persons preparing for examinations.

The question is exceptionally interesting and the Illinois examiners have done wisely in supplying so much first hand information on account keeping for blast furnaces. The problem is not difficult, yet it covers the subject so completely that one cannot help but admire the arrangement of details and the manner in which it is presented. Any person with a fair knowledge of blast furnaces and cost accounting should have little or no trouble in supplying suitable answers. In providing a solution, however, it is necessary to use one's own judgment in connection with a few of the points which present themselves. This, of course, is a prerequisite in any case. We are asked for a Cost Sheet, a Statement of Profits and Income, and a Balance Sheet. These statements are, of course, to be interlocked by accounts which are familiar to every accountant. For instance, the balance from the Cost Sheet constitutes the "cost of manufacturing the output" and is transferred to the Profits and Income account; the balance from that account in turn is transferred to the Balance Sheet as "Net Profit."

Pig Iron consists of large bars of metal or iron after it is separated from the ore and other extraneous matter with which it is mixed when it comes from the mines. The ore is melted or boiled in a large furnace and the molten metal is then run off into moulds at necessary periods. The large bars of iron thus moulded are called pigs, or raw pig iron, and are ready for transportation to the iron foundries where they are put through further processes and made into different grades of iron. The blast furnace consists of a large cupola or furnace into which the ore, coke or coal and limestone are thrown. The heat within the furnace is fanned by air drafts or blasts from the bottom, usually forced in by ordinary revolving fans,

and this force or blast causes the flames to rise for many feet above the top of the furnace, a sight which is familiar to persons who have seen blast furnaces in operation.

The contents of the furnace being raised to an intense heat by the combustion of the fuel, are brought into a softened state, the limestone parts with its carbonic acid, and combining with the earthly ingredients of the ironstone, forms, with them, a liquid slag, while the separated metallic particles, descending slowly through the furnace, are deoxidized and fused; in their passage they imbibe a portion of carbon, and at last settle down in the hearth, from whence they are run off into pigs about every twelve hours; the slag, being lighter, floats upon the surface of the liquid metal and is constantly flowing out over a notch in the dam-plate, level with the top of the hearth.

A careful study of the process in all its details should be made by the person desirous of fully qualifying himself along this line of work. Indeed, the accountant should have at least a working knowledge of manufacturing processes in general, before he can presume to hold himself out as a fully qualified cost accountant.

The blast furnaces are strongly built to withstand the tremendous heat and pressure within. The lining is composed of fire brick and fire clay and is required to be replaced every three or four years. The blast furnace itself will last from 10 to 15 years or more, according to the strength of the structure. The furnace structure is usually from 30 to 50 feet high and in some cases even higher, and the capacity is anywhere from 5,000 to 20,000 cubic feet or more. The reader can see by an examination of the statements how the various accounts have been divided, yet a few points of explanation may be necessary.

In the manufacture of pig iron, the unit consists of one ton. In another line of industry it may consist of one hundredweight, one dozen, or one finished article, as the case may be. The inventory sheet, presented herewith, is not called for, but there is no doubt of its convenience in working up the data necessary for the statements. Handling and delivering the materials has been added as a part of the cost thereof, and so considered in the inventories also. This handling cost is just 10 cents per ton for the ore, and 5 cents for the coke and limestone. The operating expenses listed on the Cost Sheet, might even be modified by the omission of taxes and insurance or by the addition of exploration and development expenditures. It will be seen that the cost of manufacturing 115,000 tons of pig iron is $1,656,400 or $14.40 per ton. It will be seen, however, that we have inventoried the pig iron on hand, December 30, 1911, at $15.00 per ton, to follow out the plan of pricing evidently adopted by the company as shown by its inventory on January 1, 1911. No doubt this is more nearly the average cost price of manufactured or purchased pig iron. This gives an apparent profit of $7,200 as indicated in the statements. The inventory sheet shows very clearly the analysis of prices.

It is apparent that the statements asked for could have been arranged differently, and that the items therein might properly be differently located. Reserves are listed among the liabilities, but it is well known that they are frequently shown as a deduction from the property represented. One-tenth

of the bond discount, $2,000, has been taken off, leaving $18,000 as a deferred charge. This is on the basis of their still having ten years to run. To be sure, the problem indicates eleven years to run, but there is no doubt an oversight some way. Equal or even amounts are usually written off bond discount annually, and since bonds usually run an even number of years, uneven amounts do not usually obtain. Following the letter of the question, however, it would seem right to spread the discount over eleven years. The amount reserved this year for relining the blast furnace is less than the actual amount expended, which was $38,500, but it must be observed that relining is only required about every third year. The Federal corporation tax is 1% of the profits after deducting $5,000. In this case it is 1% of $264,200 ($269,200—$5,000), the resulting net profit before deducting the tax itself. The various deferred charges and prepaid expenses are clearly shown in the statements.

Profit on the sale of purchased pig iron is taken as a side transaction and so considered in the solution. Likewise the miscellaneous. The supply stores have been charged off during the year to various operating expense accounts, so that only the inventory remains.

UNITED STATES INTERNAL REVENUE REPORT.

(From Florida C. P. A. Examinations—April, 1911.)

A PUBLISHING Company which has closed its books on June 30, 1909, and also on June 30, 1910, wishes you to make up for them a revenue account for the year ending December 31st, 1910, and also fill out the return to be made to the Internal Revenue Department of the United States, as required by law.

As information you are given Trial Balance of Dec. 31, 1909, June 30, 1910, and Dec. 31, 1910, also Balance Sheet of July 1, 1910; paper and supplies of the Job Department Inventories $3,000. All insurance has expired; $2,500 of bad debts have been charged off. Machinery depreciated 5%; building depreciated 2½%; total paid up capital stock of the Corporation Dec. 31, 1910, is $50,000. Information required by the United States Internal Revenue Department is as follows:

Total amount of paid up capital stock outstanding.

Total amount of bonded and other indebtedness outstanding.

Gross Income.

Total amount of all ordinary and necessary expenses of operating the business.

Total amount of losses sustained January 1, 1910, to Dec. 31, 1910, not compensated by insurance or otherwise.

Total amount of depreciation.

Total amount of interest paid.

Total taxes paid.

Net Income.

Less Specific deduction allowed, $5,000.00.

Balance subject to tax of one per centum.

Trial Balance.

Debits.	Dec. 31, 1909	June 30, 1910	Dec. 31, 1910
Floating Assets	$ 50,000.00	$ 50,000.00	$ 56,000.00
Real Estate	10,000.00	10,000.00	10,000.00
Building	18,000.00	18,000.00	18,000.00
Machinery and Fixtures	40,000.00	42,000.00	45,000.00
News Department Expenses:			
Labor	15,000.00	35,000.00	17,000.00
Circulation	10,000.00	22,000.00	9,000.00
Miscellaneous	5,000.00	11,000.00	1,000.00
Job Department Expenses:			
Labor	10,000.00	23,000.00	11,000.00
Miscellaneous	1,500.00	2,100.00	2,000.00
Supplies	10,600.00	13,000.00	8,000.00
General Expenses	200.00	200.00	150.00
Salaries	4,000.00	8,000.00	4,000.00
Insurance	1,200.00	3,000.00	1,200.00
Interest and Discount	400.00	700.00	250.00
Taxes	250.00	800.00	650.00
	$176,150.00	$238,800.00	$183,250.00
Credits.			
Floating Liabilities	$ 33,000.00	$ 30,550.00	$ 22,700.00
Capital and Surplus	80,150.00	80,150.00	93,250.00
Advertising Sales	30.000.00	70,000.00	42,000.00
Subscription Sales	10,000.00	16,000.00	6,000.00
Job Sales	22,000.00	40,000.00	18,000.00
Rent of Building	1,000.00	2,100.00	1,300.00
	$176,150.00	$238,800.00	$183,250.00

Balance Sheet.

Assets.		Liabilities.	
Floating Assets	$ 50,000.00	Floating Liabilities	$ 30,550.00
Real Estate	10,000.00	Capital and Surplus	93,250.00
Building	18,000.00		
Machinery and Fixtures	42,000.00		
Job Dept. Supplies, Inventory	3,000.00		
Insurance Unexpired	800.00		
	$123,800.00		$123,800.00

Answer and Comments.

Returns for revenue purposes prior to 1913 had to be made to the Internal Rvenue Department as on Dec. 31st of each year. This was amended in 1913, permitting a corporation to choose the end of any month for closing its fiscal year; in which case notice should be given to the collector thirty days prior. Returns must be made sixty days after the close of the fiscal year. For failure to comply with the provisions of the law a double penalty is imposed; the amount of the assessment is increased 50 per cent, and liability to a specific penalty of from $1,000 to $10,000 is incurred. The Net Income of this company is $16,100.00; from this is deducted the exemption of $5,000, leaving a net of $11,100 on which the assessment tax of one per centum is to be calculated, $111. The addition of 50% would make a total tax of $166.50, with the added liability of a fine. It will be seen that the fiscal year of this company ends on June 30, yet the report, or returns, to the Department must be made as of December 31, regardless of the company's closing date. This added inconvenience worked a hardship in many cases where the business year ends on some other date than Dec. 31, and to

obviate the inconvenience, as above stated, a bill was introduced and the matter righted by Act of Congress in 1913.

We are asked in the problem under discussion for a Revenue Account for the fiscal year ended Dec. 31, 1910, and also for the return to be made to the Department of Internal Revenue of the United States. Both are included herewith, though it will be seen that the latter is simply a brief statement of results while the one to be retained by the Company contains a detailed statement of operations, sales and expenses. The question is not difficult, but merely draws out the candidate's knowledge of analyzing amounts given at different dates for the purpose of making out the Revenue Report. There is very little difficulty attached to preparing the revenue report to be sent to Washington since the official blanks and instructions are clear and fully explained.

The trial balances are arranged in tabular order as a convenience for analyzing the accounts, though it may be that no great service has been gained by the arrangement. A balance sheet is not asked for, but the student of accounting would benefit by preparing one from the information set forth as it would enable him to prove his results. In estimating depreciation only one year has been considered, yet it seems evident that none has been considered heretofore. If that were true, additional depreciation should be provided in order that the properties may be shown at their correct valuation. The problem states that $2,500 has been charged off for bad debts, but apparently this has not been done and is therefore treated accordingly. It will be seen that the third trial balance shows $1,200 in the insurance account, but $800 of this had been carried as an inventory from the previous period.

In answering this question we have purposely given a greater amount of matter than would be required by the examiners, in order to provide a suitable lesson for those who are studying accountancy. The tabulated trial balances assemble the results of the various periods for the purpose of analysing the results of each period. The trial balance covering 18 months can be obtained easily, but in order to make one for the calendar year some adjustments must be assumed to have taken place. By assuming that the nominal accounts were closed Dec. 31, 1909, and allowing an inventory to supplies of $3,000, we have a net profit for the six months, of $7,850, thus showing surplus as on Jan. 1, 1910, to be $38,000. By doing this we are given a logical basis for the assembling of items for 1910. Since the books were closed on June 30, 1910, we must make adjustments for the six months ended Dec. 31, 1910, in case the ledger is to be closed on that date. A revenue account for the half year is therefore included which should accompany the year's revenue account to Dec. 31, as required by the problem. The Surplus account is shown as part of each revenue account with slight differences in the application of profits, but with like results. The report for Washington is shown herewith. Two forms are supplied by the Department, but only one is required to be filled. A copy should be retained by the corporation making returns. The blanks contain printed instructions on the back for the guidance of persons making out the reports, and are given below. These reports and the laws and regulations pertaining thereto are of interest to accountants and should be

studied with care. Form No. 637 for Manufacturing Corporations is given herewith. The six classes into which corporations are grouped are as follows, each of which has its special form of report.

Form No. 634—Insurance Companies.
Form No. 635—Banks and other financial institutions.
Form No. 636—Transportation Corporations.
Form No. 637—Manufacturing Corporations.
Form No. 638—Mercantile Corporations.
Form No. 639—Miscellaneous Corporations.

The above forms vary but slightly, in order to accommodate themselves to the details required of different kinds of corporations. It is obvious that slight variation would be required between the reports of insurance companies, banks, and manufacturing corporations. Charitable institutions and building and loan associations are exempt from taxation. Others are required to pay 1 per cent. tax on all net profits in excess of $5,000. Space will not permit of including further details, but as stated above the Act itself and the definitions and decisions should be studied.

Instructions.

1. This return should be filed with the collector as soon as possible after the 1st day of January each year.

2. This return must be properly filled out and verified and be in the hands of the collector on or before the 1st day of March. The penalty for failure to make the required return within the time specified by law is one (1) to ten (10) thousand dollars. The assessment against delinquent corporations will also be increased 50 per cent of the amount found due.

3. Every corporation, joint stock company, or association not specially enumerated in section 38 of the act of August 5, 1909, as exempt, and every insurance company, shall make the return required by law, regardless of the amount of its net income, whether above or below $5,000.

4. The return should be made on the required form and must be made on the prescribed form and must be for the calendar year.

5. The return of each corporation must be verified by its president, vice-president, or other principal officer, and its treasurer or assistant treasurer.

6. The seal of the attesting officer should be impressed on the return in the space reserved for such purpose. Affidavits should be made before a notary public or other officer using a seal authorized to administer oaths. If before a justice of the peace, a certificate of the clerk of the court as to his authority should be attached to the return.

7. The return, properly executed, must be filed with the collector of internal revenue for the district in which the principal place of business of the corporation, etc., is located; that is, where the books are kept from which the data shown on the return is obtained.

8. If an extension of time, not exceeding 30 days from March 1, is necessitated by reason of the illness or absence of an officer required to make the return, application to the collector for such extension of time must be made on or before March 1, or within the period for which such

extension is desired. No extension of time can be granted on an application filed subsequent to March 31, or to cover a period later than that date.

9. Returns should not be made in duplicate.

10. Item No. 1 should not include unissued or treasury stock.

11. Item No. 2 should include all interest-bearing indebtedness. In the case of banking corporations, deposits should not be reported as indebtedness.

12. The amount claimed under item 5 (b) for depreciation should be such as measures the decline during the year in the value of buildings, machinery and such other property as is subject to depreciation on account of exhaustion, wear and tear, and obsolescence, and should not cover changes in the value of stocks and bonds. The change in the value of stocks and bonds is properly taken up in the inventories.

13. Depreciation, to be allowed, must be the amount estimated to have been actually sustained during the year and must be charged on the books of the corporation against the value of the property in which the depreciation occurred. Where depreciation is made good by repairs, etc., and the expense of such repairs, etc., is charged to the general expense account, no deduction for depreciation can be made in the return of annual net income.

14. The amount of interest paid on indebtedness must be limited to the interest actually paid on an amount of indebtedness not in excess of the paid-up capital stock outstanding at the close of the year.

15. Dividends declared or paid are not deductible.

16. The gross income of mercantile corporations should be ascertained in the following manner: From the sum of the total sales during the year plus the amount of the inventory at the end of the year deduct the sum of the inventory at the beginning of the year plus the cost of the goods and material purchased during the year. To this difference add the income received from any other source, and the result will be the gross income to be reported under item No. 3 on the return.

17. The gross income of manufacturing corporations should be ascertained as in No. 16, except that the cost of manufacture should be included in the deduction to be made from the sum of the sales during the year and the inventory at the end of the year.

For further instructions, see Regulations No. 31, containing the law and regulations, and Treasury Decision No. 1675, containing official rulings, copies of which will be furnished upon application to the collector of the district in which the corporation desiring same has its principal place of business.

Note.—The following tabulation contains the trial balances given in the question and two others for 12 and 18 months ending Dec. 31, 1910, arranged in form for comparison. The Balance Sheet of July 1, 1910, may be put in also in order to have all the information together. The last trial balance includes all accounts for the 18 months after making allowance for handling of inventories in accordance with problem, and including surplus as on July 1, 1909. The trial balance for 1910 is made in the assumption that surplus had been adjusted to $38,000 on Jan. 1, 1910, by the addition of a profit of $7,850 for the previous six months, allowing only for an inventory of $3,000 for supplies.

Comparative Trial Balances.

Trial Balance	1909 Dec. 31	1910 June 30	1910 Dec. 31	12 mos. to 12-31-'10	18 mos. to 12-31-'10
DEBITS:					
Floating Assets	$50000 00	$50000 00	$56000 00	$56000 00	$56000 00
Real Estate	10000 00	10000 00	10000 00	10000 00	10000 00
Building	18000 00	18000 00	18000 00	18000 00	18000 00
Machinery & Fixtures	40000 00	42000 00	45000 00	45000 00	45000 00
News Dept. Expense:					
Labor	15000 00	35000 00	17000 00	37000 00	52000 00
Circulation	10000 00	22000 00	9000 00	21000 00	31000 00
Miscellaneous	5000 00	11000 00	1000 00	7000 00	12000 00
Job Depart. Expense:					
Labor	10000 00	23000 00	11000 00	24000 00	34000 00
Miscellaneous	1500 00	2100 00	2000 00	2600 00	4100 00
Supplies	10600 00	13000 00	8000 00	10400 00	18000 00
Genl. Expense	200 00	200 00	150 00	150 00	350 00
Salaries	4000 00	8000 00	4000 00	8000 00	12000 00
Insurance	1200 00	3000 00	1200 00	2200 00	3400 00
Interest & Discount	400 00	700 00	250 00	550 00	950 00
Taxes	250 00	800. 00	650 00	1200 00	1450 00
	$176150 00	$238800 00	$183250 00	$243100 00	$298250 00
CREDITS:					
Floating Liabilities	33000 00	30550 00	22700 00	22700 00	22700 00
Capital Stock	50000 00	50000 00	50000 00	50000 00	50000 00
Surplus	30150 00	30150 00	43250 00	38000 00	30150 00
Advertising Sales	30000 00	70000 00	42000 00	82000 00	112000 00
Subscription Sales	10000 00	16000 00	6000 00	12000 00	22000 00
Job Sales	22000 00	40000 00	18000 00	36000 00	58000 00
Rent of Building	1000 00	2100 00	1300 00	2400 00	3400 00
	$176150 00	$238800 00	$183250 00	$243100 00	$298250 00

Operating and Revenue Account for six months ended Dec. 31, 1910.

Income.

Advertising Sales		$42,000.00	
Subscription Sales		6,000.00	
			$48,000.00
Less Operating Expenses:			
Labor Charges		$17,000.00	
Circulation		9,000.00	
Miscellaneous		1,000.00	
			27,000.00
Income News Department			$21,000.00
Job Department Sales		$18,000.00	
Less Operating Expenses:			
Labor Charges	$11,000.00		
Miscellaneous	2,000.00		
Supplies, net	5,000.00		
		$18,000.00	
Income Job Department			Nil
Rent of Building			1,300.00
Gross Income of Business			$22,300.00

General Expenses.

General Expense	$ 150.00	
Salaries Paid	4,000.00	
Insurance	1,200.00	
Interest and Discount	250.00	
Taxes	650.00	
Bad Debts written off	2,500.00	
Depreciation of Machinery, 5%	2,250.00	
Depreciation of Building, 2½%	450.00	
		11,450.00
Net Income for Half Year		$10,850.00

Condition of Surplus Account.

Balance of Surplus, July 1, 1909	$30,150.00	
Add Net Income, July 1, 1910	13,100.00	
		$43,250.00
Add Net Income, Dec. 31, 1910		10,850.00
Balance of Surplus, Jan. 1, 1911		$54,100.00

Operating and Revenue Account for Year Ended December 31, 1910.

Income.

Advertising Sales		$82,000.00	
Subscription Sales		12,000.00	
			$94,000.00
Less Operating Expenses:			
Labor Charges		$37,000.00	
Circulation		21,000.00	
Miscellaneous		7,000.00	
			65,000.00
Gross Income News Department			$29,000.00
Job Department Sales		$36,000.00	
Less Operating Expenses:			
Labor Charges	$24,000.00		
Miscellaneous	2,600.00		
Supplies, net	7,400.00		
		34,000.00	
Gross Income Job Department			2,000.00
Total Operating Income			$31,000.00
From Rent of Building			2,400.00
Gross Income of Business			$33,400.00

General Expenses.

General Expense	$ 150.00	
Salaries Paid	8,000.00	
Insurance	2,200.00	
Interest and Discount	550.00	
Taxes	1,200.00	
Bad Debts charged off	2,500.00	
Depreciation of Machinery, 5%	2,250.00	
Depreciation of Building, 2½%	450.00	
Total Expenses		17,300.00
Net Income for Year		$16,100.00

Condition of Surplus Account.

Balance of Surplus, July 1, 1909	$30,150.00	
Add Net Income, Dec. 31, 1909	7,850.00	
		$38,000.00
Add Net Income for Year 1910		16,100.00
Balance Surplus January 1, 1911		$54,100.00

Balance Sheet, Dec. 31, 1910.

Assets.

Floating Assets	$ 56,000.00
Real Estate	10,000.00
Building	18,000.00
Machinery and Fixtures	45,000.00
Job Department Supplies	3,000.00
Total	$132,000.00

Liabilities.

Floating Liabilities		$ 22,700.00
Reserve for Depreciation		2,700.00
Reserve for Bad Debts		2,500.00
Capital Stock		50,000.00
Surplus, July 1, 1910		43,250.00
Income Account, Dec. 31, 1910		10,850.00
	$132,000.00	$132,000.00

Note.—The above balance sheet is not required by the problem, but in deciding upon a solution it will aid in proving the results obtained.

United States Internal Revenue.

Return of Annual Net Income.

(Section 38, Act of Congress, approved August 5, 1909.)

MANUFACTURING CORPORATIONS.

RETURN OF NET INCOME RECEIVED DURING THE YEAR ENDING DECEMBER 31, 1910, by..................A PUBLISHING COMPANY...................a corporation, the principal place of business of which is located at...
Bridge and River Streets...
City or Town of Jacksonville......., in the State of ....Florida.......

1.	Total amount of paid-up capital stock outstanding at close of year		$50,000.00
2.	Total amount of bonded and other indebtedness outstanding at close of year..................................		22,700.00
3.	Gross Income (See Note A)............................		33,400.00
	DEDUCTIONS.		
4.	Total amount of all the ordinary and necessary expenses of maintenance and operation of the business and properties of the corporation EXCLUSIVE OF INTEREST PAYMENTS. (See Note B)..................	$10,350.00	
5.	(a) Total amount of losses sustained Jan. 1 to Dec. 31, not compensated by insurance or otherwise	2,500.00	
	(b) Total amount of depreciation Jan. 1 to Dec. 31	2,700.00	
6.	Total amount of interest paid Jan. 1 to Dec. 31, on an amount of bonded and other indebtedness not exceeding the amount of paid-up capital stock outstanding at the close of the year	550.00	
7.	(a) Total taxes paid Jan. 1 to Dec. 31 imposed under authority of the United States or any State or Territory thereof..........	1,200.00	
	(b) Foreign Taxes paid......................	None	
8.	Amount received by way of dividends upon stock of other corporations, joint-stock companies, associations, and insurance companies subject to this tax................................	None	
	TOTAL DEDUCTIONS (See Note B).		$17,300.00
9.	NET INCOME		16,100.00
10.	Specific deduction from net income allowed by law		5,000.00
11.	Amount on which tax at 1 per centum is to be calculated for assessment..................		$11,100.00

PUBLIC SERVICE CORPORATIONS.

A GAS COMPANY shows the following trial balance at the end of its first year of business:

Capital Stock		$ 500,000
Bonds		500,000
Accounts Payable		48,000
Gas Accounts		342,600
Manufacturing Labor	$ 5,400	
Boiler Fuel	3,200	
Generator Fuel	5,400	
Oil	126,000	
Purifiers	3,200	
Repairs, Works	2,600	
Expense, Works	3,900	
Water	1,500	
Insurance	300	
Taxes	4,800	
Distribution Labor and Material	12,000	
Office Expense	13,500	
Stable Expense	4,000	
Repairs, Mains	1,800	
Repairs, Meters	600	
Repairs, Sewers	700	
Street Lighting	300	
Advertising	300	
Maintenance Arc Lamps	1,500	
Licenses	1,000	
Discounts	34,000	
General Expense	5,000	
Sundry Debtors, Gas	40,000	
Sundry Debtors, Mdse	10,000	
Cash	29,000	
Bond Interest	25,000	
Plant	1,055,600	
	$1,390,600	$1,390,600

The inventory of manufacturing material is $20,000.

The inventory of Distribution Material is $4,000.

No other inventories of any description are carried.

The amount of gas manufactured during the year was 300,000,000 cubic feet. Amount sold 270,000,000 cubic feet. Unaccounted for, 30,000,000 cubic feet.

Give 1st, the manufacturing cost of gas sold; 2nd, the distribution cost of gas sold; 3rd, prepare statement of operations of the company and balance sheet of assets and liabilities.

SOLUTION.

I. Manufacturing Cost of Gas Sold.

Operation.

			Cost per 1000 feet
Labor		$ 5,400	$ .020
Fuel		8,600	.031
Boiler	$3,200		
Generator	5,400		
Oil		126,000	.467
Water		1,500	.005
Expense, Works		3,900	.015
Stable Expense, Estimated		2,400	.009
Purifiers		3,200	.011
		$151,000	$ .558
Less: Material on Hand		20,000	.074
Cost of Operation		$131,000	$ .484
Maintenance.			
Repair Works		$ 2,600	$ .010
Total Cost of Manufacturing		$133,600	$ .494

II. The Distribution Cost of Gas Sold.

Operation.

Labor and Material		$ 12,000	$ .045
Stable Expense, Estimated		1,600	.006
Licenses		1,000	.002
		$ 14,600	$ .053
Less: Material on Hand		4,000	.015
Cost of Operation		$ 10,600	$ .038
Maintenance.			
Repairs, Mains	$1,800		
Repairs, Meters	600		
Repairs, Services	700	$ 3,100	$ .012
Total Cost of Distribution		$ 13,700	$ .050

Statement of Operation for the Financial Year ended Dec. 31, 1910.

Gas Made as per Station Meter	300,000,000 cubic feet
Gas Sold, 90%	270,000,000 cubic feet
Gas unaccounted for, 10%	30,000,000 cubic feet

A. Manufacturing Cost.

			Total Amount	Cost per 1000 feet
Labor		$ 5,400		
Fuel		8,600		
Boiler	$3,200			
Generator	5,400			
Oil		126,000		
Water		1,500		
Expense, Works		3,900		
Stable Expenses, Estimated		2,400		
Purifiers		3,200		
		$151,000		
Less: Material on Hand		20,000		
		$131,000		
Repair Works		2,600	$133,600	$ .494

B. Distribution Cost.

Labor and Material		$ 12,000		
Stable Expense, Estimated		1,600		
Licenses		1,000		
		$ 14,600		
Less: Material on Hand		4,000		
		$ 10,600		
Repairs, Mains	$1,800			
Repairs, Meters	600			
Repairs, Services	700	3,100	$ 13,700	$ .05

C. General Expense and Management.

Office Expense	$ 13,500		
Advertising	300		
General Expense	5,000		
Insurance, Expired	300	$ 19,100	$ .073

D. Taxes.

Taxes Accrued and Paid for Year	$ 4,800	.017
Total Manufacturing Cost	$171,200	$ .634

E. Street Lamp Operating.

Street Lighting	$ 300		
Maintenance Arc Lamps	1,500	1,800	$ .006

F. Discount.

Amount Allowed for Year		34,000	.126
Total Expenditure		$207,000	$ .766
Profits, Carried to Profit and Loss Account		135,600	.500
Sales of Gas		$342,600	$1.266

Profit and Loss Statement.

Profits, Carried from Statement of Operations	$135,600	$ .500
Less: Bond Interest	25,000	.091
Net Profits Transferred to Surplus Account	$110,600	$ .409

BALANCE SHEET, DEC. 31, 1910.

Current Assets.

Cash		$ 29,000	
Customers			
Merchandise	$ 10,000		
Gas	40,000	50,000	
Inventories:			
Material, Manufacturing	20,000		
Material Distribution	4,000	24,000	$ 103,000

Fixed Assets.

Plant			1,055,600
			$1,158,600

Current Liabilities.

Accounts Payable		$ 48,000	

Fixed Liabilities.

Bonds		500,000	

Capital and Surplus.

Capital Stock	$500,000		
Surplus	110,600	610,600	
			$1,158,600

Comments.

In preparing the operation statement the following accounts should be further explained.

Stable expenses have been pro-rated over the manufacturing and distribution costs; the stable expenses are intended to show cost of all labor, material and expense, in connection with company's teams.

License account is interpreted to mean licenses granting permission to open streets, and is therefore a distribution office expense.

Street Lamp Operating shows the cost of all labor and material employed in operating and repairing street lamps. It is set out as a separate item.

Depreciation, being a loss incident to the holding of certain assets for the purpose of earning income, should be clearly set off against such income as a working expense before profits are arrived at. It should be remembered that depreciation affects revenue account and balance sheet as well. Hence, unless provision is made for depreciation, the true profits or losses are not demonstrated, and the balance sheet does not show a true and correct view of the state of affairs. In the problem under review, plant, stated in one amount, should be depreciated.

CONSIGNMENTS.

A, B & CO. AGREE with C, D & Co. that the latter shall ship on consignment to Honolulu on joint account, 20 cases of commodity "X," the invoice price of which is $2,100, less 2½%. A, B & Co. pay the packing charges, $25; also freight, insurance, and other charges, $90, and they draw on their correspondents in Honolulu in advance for $1,600, at 90 days, which is discounted at a cost of $20, and the proceeds handed to C. D. & Co. as part-payment. These transactions may be dated March 31. On the 30th of November, A, B & Co. receive the account sales and net proceeds, $418, and they then pay C, D & Co. the balance due to them.

Prepare a joint consignment account, charging interest on the amount lying out at 5 per cent per annum for eight months, closing it by dividing the loss. Also an account to be rendered by A, B & Co. to C, D & Co., closed by payment of the balance and prove that the losses borne by each are equal.

Comments.

A joint consignment account is a partnership of a temporary kind.

In actual practice, joint adventures are broadly divided into two classes:

Class "A"—A separate set of books is opened for the transactions of the joint venture and a joint bank account is used.

In this case the transactions are recorded in precisely the same manner as those in ordinary partnerships, each partner's capital account being credited with his investment brought into the joint account. Interest is calculated on the capital, and the profits or losses shared in the proportions agreed upon.

Class "B"—No separate set of books is opened for the transactions of the joint venture; each party records the transactions he enters into on behalf of the joint account in his own books, and no joint bank account is opened.

Under this method, in order to determine the profit or loss, each party must render a complete statement of all transactions entered into by him, combine the transactions into a joint venture account, which would not appear in the books of either party, but would be raised from materials supplied by all concerned. This account is really a trading account. The results having been ascertained, each party will debit or credit his account with the joint venture, in his own books, with his share of the results; the balance of this account will then show the amount due to or by the other party or parties.

An "interest account" has been raised in order to show:

A—The profit or loss from merchandise operations proper.

B—The profit or loss from interest or other sources.

C—Combined, the final results will be shown.

SOLUTION.

JOINT CONSIGNMENT ACCOUNT, A, B & CO. AND C, D & CO.

Honolulu Correspondents.

Mch. 31.	Commodity "x," net..	$2,047.50	Mch. 31.	Cash	$1,580.00
	Cash, packing	25.00		90 day dft., $1,600.00 less disc.,... 20.00	
	Cash, freight, ins., etc.	90.00	Nov. 30.	Cash	418.00
				From Honolulu correspondents, paid over to A. B. & Co.	
					$1,998.00
			Nov. 30.	Balance, loss transferred to P. & L. acct.	164.50
		$2,162.50			$2,162.50

C. D. & Co.'s Account.

Mch. 31.	Cash	$1,580.00	Mch. 31.	Commodity "x"	$2,047.50
	Remitted by A. B. & Co.		Nov. 30.	Interest	68.25
Nov. 30.	Interest	52.66		On $2,047.50, 8 mos., at 5%	
	On $1,580, 8 mos., at 5%				
Nov. 30.	½ loss ....$	91.96			
Nov. 30.	Cash	391.13			
	Remitted by A. B. & Co., per "Account Sales," to balance account.				
		$2,115.75			$2,115.75

Interest Account.

Nov. 30.	A., B. & Co. ....$	3.83	Nov. 30.	C. D. & Co. ....$	52.66
	C. D. & Co............	68.25		Profit & Loss acct. .	19.42
		$ 72.08			$ 72.08

Profit and Loss Account.

Nov. 30.	Loss on merchandise..$	164.50	Nov. 30.	Loss on operations.	
	Per Joint Consignment acct.			½, A. B. & Co. .....$	91.96
	Loss on interest.......	19.42		½, C. D. & Co.	91.96
	Per interest acct.				
		$ 183.92			$ 183.92

A, B & Co.'s Account Rendered to C, D & Co.

Nov. 30	½ loss on operations..$	91.96	Mch. 31.	Cash, packing ....$	25.00
	Cash	418.00		Cash, freight, ins., etc..	90.00
	From Honolulu correspondents.		Nov. 30.	Interest	3.83
				On $115, 8 mos., at 5%	
				Cash, to C. D. & Co....	391.13
				Remitted to balance account.	
		$ 509.96			$ 509.96

SYNDICATES AND HOLDING COMPANIES.

Problem No. 1.

EIGHT MEN form an association to build 100 houses and distribute same among themselves. After selling all but 35 of the equities they decide to close out these to a stock company for $75,000, taking in settlement capital stock of said company. The equities are carried at $54,776.33.

The capital account on the 30th of April, 1910, of the original association or syndicate amounted to $41,500; divided into 40 parts, the holders being: E. Coke, 5—40; S. Coler, 1—10; A. Maddis, 1—5; D. Sale, 1—40; C. Scope, 1—8; B. Divin, 1—10; J. Gaines, 9—40; and J. Muir, 1—10.

The association owes the Kevan Company $3,913.34, being a balance due on construction work on the houses. There has accrued, to the 30th of April, 1910, interest on mortgages on the 35 properties still in hand $2,886.12; water rents unpaid but accrued, $995.88, and accrued taxes, $202.86.

The unpaid rents receivable from 28 tenants amount to $1,430, while one tenant has overpaid $25.

J. Muir, one of the members, is indebted on personal account to the syndicate $304.15. On the other hand, the other members of the association are creditors on personal account as follows: E. Coke, personal, $1,425.80; S. Coler, personal, $1,119.65; A. Maddis, personal, $2,281.28; D. Sale, personal, $285.16; C. Scope, personal, $775.80; B. Divin, personal, $828,98; J. Gaines, personal, $270.61.

The Kevan Company will assume the settlement of the affairs of the association, provided the individual members will pay what is necessary to do so, and, of course, to pay the Kevan Company whatever may be due to it.

Show the least amount necessary from them all or any member to effectuate this and close out the old association. The relationship of each member of the syndicate must be shown on the final statement.

Answer:

OLD ASSOCIATION.

Balance Sheet April 30, 1910.

ASSETS.

Equity in properties		$54,776.33
Rents receivable	$1,430.00	
Less prepayment	25.00	1,405.00
Total assets		$56,181.33

LIABILITIES.

Interest accrued on mortgages	$ 2,886.12	
Water rents accrued	995.88	
Taxes accrued	202.86	
Due to Kevan Company	3,913.34	
Total current liabilities		$ 7,998.20
Owing to members	$6,987.28	
Due from members	304.15	
		6,683.13
Capital of members		41,500.00
		$56,181.33

Net capital or interest of members, $48,183.13.

Statement of Sale and Profit Adjustment, April 30, 1910.

Sale of equity in 35 houses for stock in Company, 3,000 shares at $25 each	$75,000.00
Deduct equity in houses, including improvements and carrying charges to date	54,776.33
Profit on sales	$20,223.67

The profit is to be distributed to the various partners in proportion to their capital holdings, regardless of their personal accounts with the syndicate. This distribution is shown on the accompanying tabulated statement.

Status of Capital Accounts Upon Dissolution, April 30, 1910.

Member	Share	Capital	Personal Ac. Dr.	Personal Ac. Cr.	Gain Cr.	New Stock Dr.	Paid in Cash Balance Dr.	Gets Shrs. Stock
E. Coke	5-40	$5,187.50	....	$1,425.80	$2,527.96	$9,375.00	$233.74	375
S. Coler	1-10	4,150.00	....	1,119.65	2,022.37	7,500.00	207.98	300
A. Maddis	1-5	8,300.00	....	2,281.28	4,044.73	15,000.00	373.99	600
D. Sale	1-40	1,037.50	....	285.16	505.59	1,875.00	46.75	75
C. Scope	1-8	5,187.50	....	775.80	2,527.96	9,375.00	883.74	375
B. Divin	1-10	4,150.00	....	828.98	2,022.37	7,500.00	498.65	300
J. Gaines	9-40	9,337.50	....	270.61	4,550.32	16,875.00	2,716.57	675
J. Muir	1-10	4,150.00	304.15	....	2,022.37	7,500.00	1,631.78	300
Total	40-40	$41,500.00	$304.15	$6,987.28	$20,223.67	$75,000.00	$6,593.20	3000

Note—Stock in new company is apportioned to members on the basis of $25 per share.

The partners must pay in to the syndicate $6,593.20, which shall then be turned over to the Kevan Company to settle current liabilities, less rents due and unpaid, as per statement of assets and liabilities.

The relationship of each member is clearly shown above, and the amount due from each.

Journal Entries on Books of Syndicate.

The following entries are given to show the steps in making the various adjustments at the time of sale. It is presumed that entries have already been made for rent accrued and prepaid, interest accrued, water rates, taxes, etc., and that mortgage account has been closed into real estate.

April 30, 1910.

Entry No. 1.

Corporation stock	$75,000.00	
To Real Estate		$75,000.00

For sale of equity in real estate valued at $54,776.33 in exchange for shares of stock valued at $75,000.00.

Entry No. 2.

Real estate	$20,223.67	
To Capital accounts		$20,223.67

For profit on sale of equity in 35 houses, distributed to the partners in proportion to holdings. (See accompanying tabular statement for distribution.)

Entry No. 3.

Personal accounts	$ 6,997.28	
To Capital accounts		$ 6,997.28

For adjustment of personal accounts into the corresponding capital accounts. (Distribution shown in tabular statement.)

Entry No. 4.

J. Muir, capital	$ 304.15	
To J. Muir, personal		$ 304.15

For adjustment of personal account as above.

Entry No. 5.

Kevan Company	$ 1,405.00	
To Rent account		$ 1,405.00

For entry of accrued rent to account of Kevan Company for settlement, per agreement. Balance of rent account used.

Entry No. 6.

Interest accrued	$ 2,886.12	
Water rates accrued	995.88	
Taxes accrued	202.86	
To Kevan Company		$ 4,084.86

For liabilities of the syndicate assumed by Kevan Company, per agreement.

Entry No. 7.

Capital accounts	$75,000.00	
To Corporation stock		$75,000.00

For distribution of corporation stock to the eight partners in proportion to their holdings. (Distribution shown in tabular statement.)

Entry No. 8.

Cash	$ 6,593.20	
To Capital accounts		$ 6,593.20

For cash received from partners in settlement of their balances. (See tabular statement.)

Entry No. 9.

Kevan Company	$ 6,593.20	
To Cash		$ 6,593.20

For payment of amount due them on contracts and for accounts of the syndicate taken over by them, per agreement.

The above entries close off all of the accounts of the syndicate, and the stock received by the partners is divided in proportion to interests. The account of the Kevan Company would appear as follows:

Kevan Company.

1910.		1910.	
April 30—Rent	$1,405.00	April 30—Balance	$3,913.34
April 30—Cash	6,593.20	April 30—Interest	2,886.12
		April 30—Water rates	995.88
		April 30—Taxes	202,86
	$7,998.20		$7,998.20

Comments.

The problem does not state the book value of real estate held by the syndicate nor the amount of mortgages outstanding against it. The equity, however, is given as $54,776.33, the excess of real estate valuation over and above the mortgage incumbrance. The interest accrued on mortgages is given, but we are not told for what length of time nor at what rate per cent. We might consider it as for four months at 6%, thereby giving mortgages payable as $144,306.00 (2% —$2,886.12) and real estate as $199,082.33 ($144,306.00 plus $54,776.33), or a valuation of $5,688.07 per house. This estimate, however, is not reliable, since the time and rate are not known. The equity given, $54,776.33, includes, no doubt, all carrying charges such as interest, taxes and water rates, as shown in the accompanying statement.. It is the custom of building operators to add to the original value of the properties proportional amounts for maintenance, improvements and carrying charges, but it is evident that the longer the houses are carried the lower will the net profit be when sold.

We are not told the name of the company whose stock was received in payment for equities in real estate, but it presumably was the Kevan Company, since it has agreed to assume the settlement of current accounts. The current accounts have been adjusted into the Kevan Company's account, as shown herewith. The gain from rents receivable and the losses for accrued charges have evidently been adjusted through profit and loss account into real estate account or to the credit of the partners' personal accounts. The latter is presumed. The accompanying journal entries are not asked for, but are given in order to show in proper sequence the steps required in making the several adjustments. The

accompanying tabulated statement shows the condition of each partner's account, as well as totals, both before and after adjustment; and it includes the apportionment of profits and of shares of stock to the various partners. The balance remaining indicates the amount each must pay up for the satisfaction of obligations owing to the Kevan Company. Shares of stock are assumed as having a par value of $25.00 each. The fact that there are 28 tenants has no particular bearing on the results to be obtained.

Problem No. 2.

The Boulevard Land Corporation is organized in your home city for the purpose of acquiring 100 acres of land, having the same laid off into suitable lots for residential property.

The company is capitalized at $25,000, which stock is taken in equal amounts and paid for by ten stockholders. The property is purchased for $35,000.00; a first mortgage being accepted for $15,000.00 and the balance $20,000.00 paid in cash, the remaining $5,000.00 derived from sale of capital stock being used to advertise and pay expenses of putting the property on the market.

There is a release clause in the mortgage providing that all owners of lots on the boulevard can obtain clear title by paying $25.00 per front foot to the mortgagee, all other lots being released at rate of $15.00 per front foot.

The stockholders decided to reserve ten lots 50 feet in width, facing the boulevard, for their own use; each stockholder drawing a lot number from a hat to ascertain which one of the ten should belong to him.

A and B are engaged in the real estate business and are also stockholders in this corporation, and by vote of the stockholders are appointed the general sales agents for the Boulevard Land Corporation.

In making an audit of the accounts you find that the company has paid $9,500.00 in release; $7,000.00 to release lots purchased by outsiders; and $2,500.00 to pay for the release of free lots drawn by A and B as stockholders. Would you have any comment to make regarding this or any adjustments to make in the accounts? Explain in detail.

SOLUTION.

This question is not difficult, and in order to answer it correctly one must have a working knowledge of the real estate business. In this case we have a corporation organized for the development and sale of building lots. It is usual for a company of this kind to purchase a large tract of land and then divide it up into blocks or lots for sale to customers. The development of such a tract necessarily requires a considerable outlay of money and co-operation of the city authorities, the latter being necessary in the matter of planning the streets, sewers, water and other conveniences. It is usual for a development company of this kind to issue a mortgage, as in this case, as part of the purchase money, with some understanding as to the method of making releases of indi-

vidual lots purchased by customers who desire clear titles. It is not unusual to make these sales of lots to persons who cannot lift the mortgage, in which case said mortgage is usually permitted to remain as it is, or a transfer made from the operating company to the purchaser; that is, the mortgagee will now hold the mortgage from the purchaser covering this building lot.

We see that the present mortgage provides for a release of lots and transfer of title by payment to the mortgagee of so much per lot. This payment, of course, is applied to the reduction of the original mortgage of $15,000. The question might be raised as to the right of the directors to reserve ten lots as stated, for their own use. So long as the company is doing well, however, and no one is imposed upon by this transaction, the auditor would hardly be justified in criticising it. The fact that the ten lots have been reserved does not necessarily mean that all of the persons who drew them have secured clear titles to their lots. It seems, however, that A and B have taken title, as is evident by the payment of $2,500 shown in question.

We are told that the company has paid $9,500 in releases, $7,000 of this belonging to lots purchased by outsiders. Lots are usually sold subject to mortgage, in which case the amount paid for the lot, over and above that required for mortgage release, goes to the company, while the balance is paid by the purchaser to the mortgagee. It is not unusual, however, for development companies to accept the entire amount from the purchaser and then transfer the required amount to the mortgagee for the purchase of clear title. In the present case it appears that purchase moneys were paid to the Land Company, and it in turn purchased releases from the mortgagee. We are not told whether titles to lots drawn by the stockholders were purchased by the company from the mortgagee without payment for same having been made by said stockholders. We are presuming that each stockholder is to purchase his own release in making entries for the transaction.

The lots taken by stockholders may be charged up as selling expenses or as promotion expenses, as the case may be. In any case a resolution legalizing the matter should be passed by the board of directors and placed upon the minutes of the company. As stated before there is nothing wrong with the transaction, and it no doubt would have been advisable to handle them in the form of dividends, in which case the directors would necessarily have declared a dividend payable in building lots.

Journal Entries.

Entry 1.	Cash	$25,000.00	
	To Capital stock		$25,000.00
	For incorporation of the Boulevard Land Corporation with a capital stock of $25,000.00 paid in full by the ten stockholders mentioned herewith.		

Entry 2.	Real estate	35,000.00	
	To Mortgage payable		15,000.00
	To Cash		20,000.00
	For purchase of 100 acres of land for the development and sale of building lots. The mortgage contains release clauses as specified herewith.		
Entry 3.	Selling expenses	5,000.00	
	To Cash		5,000.00
	For advertising and selling expenses.		
Entry 4.	Customers and Cash	20,000.00	
	To Sale of lots		20,000.00
	Amount assumed as sales of lots, though considerable more than this may have been made. No particulars are given on this point.		
Entry 5.	Mortgage payable	9,500.00	
	To Cash		9,500.00
	For obtaining clear title to lots by release of mortgage. This, of course, is on the presumption that the purchase money has all been received by the company.		
Entry 6.	In case the company makes sale of and receives only its equity in lots and the mortgages are assumed by purchasers, the entries would be similar to the following:—		
	Cash	700.00	
	Mortgage payable	300.00	
	To Sale of lots		1,000.00
Entry 7.	When drawings were made by the stockholders an entry similar to the following would be in order, thus taking credit for these transfers in the sales account.		
	Selling expenses	5,000.00	
	To Sales of lots		5,000.00
	For reservation of ten lots for benefit of stockholders, per agreement of the directors.		

In case a dividend had been declared an entry debiting profit and loss and crediting dividend would be in order. Under this plan dividend would be debited and either sales or stockholders credited. If stockholders are to be credited it would indicate that they had been charged with lots at the time the reservation was made.

As already stated the directors and stockholders may be given these free lots if they wish, so long as no one else is injured.

The company, (the ten stockholders) has paid for the property and may dispose of it as it sees fit. An auditor would be concerned only to see that all stockholders agreed to the matter, and to see that capital stock was not impaired. Probably a few adjusting entries would be needed, but as we are not given any data as to what entries have already been made, it is impossible to advise what additional entries or adjustments are needed.

STOCK BROKERS' ACCOUNTS.

Problem No. 1.

A, B AND C form a co-partnership to engage in the business of buying and selling stocks on commission. A is a special partner and B and C are active partners. A and C each contribute $100,000 cash capital; and B, who owns a seat in the Stock Exchange valued at $75,000 turned in, contributes $25,000 additional capital. A is to receive interest on his capital at 6% and 1-6 of the net profits. B and C are each to receive 5-12 of the net profits.

At the end of the first year the condition of the business is as follows:
Capital (subject to profits and withdrawal) as originally invested.

New York City bonds, 4%, purchased at par for office account...	$3,100,000
Stock in office safe purchased for account of customers..........	171,000
Customers' accounts, long:	
No. of shares bought, 35,000, market price................	2,500,000
Cash margin, par 10%..............................	350,000
Balance	$2,150,000
Customers' accounts, short:	
No. of shares sold, 6,500, market price....................	585,000
Cash margin, par 10%..............................	65,000
Balance	$ 650,000

Bank loans on city bonds, par value $3,000,000 less 5% margin.
Bank loans on stocks, market value $624,000 less 20% margin.
Stocks borrowed and loaned to account for full complement of securities.
Commission earned, $88,700; excess of interest earned over interest paid, exclusive of interest on A's capital, $41,300.
Office salaries, $7,800; office expenses, rent, etc., $40,000.
Partners' drawings, A, $15,000; B, $30,000; C, $30,000.

Prepare a statement showing the cash on hand, also a profit and loss account and a balance sheet.

DEBITS

TO RECEIVE (Day and date) CASH PAYMENTS

Bought from	No. of Shares	Description	Price	Am't.	Com.	Net Amount	Sundries	L F	Account of
		N. Y. City Bonds	Par				$3,100,000		N. Y. City Bonds
		Seat on Exchange					75,000		Membership
		Stocks bought					2,500,000		Customers, Long
		Stocks borrowed					585,000		Borrowed Stock
		Cash Paid					7,800		Office Salaries
		" "					40,000		" expense
		" "					15,000		A Drawing ac.
		" "					30,000		B " "
		" "					30,000		C " "
		Cash Balance					101,400		Balance
							$6,484,200		

NOTE—In actual work all of the above columns would be used. The complete form is given in order to show the various columns usually required.

CREDITS

TO DELIVER (day and date) CASH RECEIPTS

Sold to	No. of Shares	Description	Price	Am't.	Com.	Net Amount	Sundries	L F	Account of
		Investment					$100,000		A Capital
		"					100,000		B "
		"					100,000		C "
		Cash Margins					350,000		Customers, Long
		" "					65,000		" Short
		Stocks Sold					585,000		" Short
		Loans on bonds					2,850,000		Bank Loans
		" " stocks					499,200		" "
		Comm. earned					88,700		Commissions
		Net Int. earned					41,300		Interest
		Stocks loaned out					1,705,000		Stock Loans
							$6,484,200		
		Cash in bank					$101,400		Balance

Trial Balance.

		Dr.	Cr.
A. Capital			$ 100,000.00
B. Capital			100,000.00
C. Capital			100,000.00
A. Drawing Account		$ 15,000.00	
B. Drawing Account		30,000.00	
C. Drawing Account		30,000.00	
Real Estate			
Office Equipment			
Investments (specified)			
New York City Bonds		3,100,000.00	
Cash or Bank		101,400.00	
Petty Cash			
Customers, Long, Balance		2,150,000.00	
Customers, Short	$585,000		
Margin	65,000		650,000.00
Exchange Membership		75,000.00	
Borrowed Stock		585,000.00	
Loaned Stock			1,705,000.00
Bank Loans, Bonds			2,850,000 00
Bank Loans, Stocks			499,200.00

Commissions		88,700.00
Interest Earned		41,300.00
Interest on Loans		
Office Expenses	40,000.00	
Office Salaries	7,800.00	
Telegraph Expenses		
Rent, etc.		
Error Adjustment Account		
Profit and Loss		
	$6.134.200.00	$6.134,200.00

Profit and Loss Account.

EXPENSES.			EARNINGS.	
Office expenses		$ 40,000.00	Commissions	$ 88,700.00
Office salaries		7,800.00	Interest	41,300.00
Net profit		82,200.00		
		$130,000.00		$130,000.00
Interest to A		$ 6,000.00	Net profit, down	$ 82,200.00
Profits divided:				
A. 1-6	$12,700			
B. 5-12	31,750			
C. 5-12	31,750	76,200.00		
		$ 82,200.00		$82,200.00

Balance Sheet.

ASSETS.		LIABILITIES.		
New York City bonds	$3,100,000.00	Customers—Short:		
Cash in bank	101,400.00	Margin deposits		$ 65,000.00
Exchange membership	75,000.00	Sales, Short		585,000.00
Customers—Long	2,150,000.00	Bank Loans:		
Borrowed stock	585,000.00	Bond security		2,850,000.00
		Stock security		499,200.00
		Loaned stock		1,705,000.00
		Capital Accounts:		
		A.'s investment	$100,000	
		B.'s investment	100,000	
		C.'s investment	100,000	300,000.00
		Undivided Profits:		
		A.'s balance	3,700	
		B.'s balance	1,750	
		C.'s balance	1,750	7,200.00
	$6,011,400.00			$6,011,400.00

Stock Loans.

Purchased for customers		$2,500,000.00
Deduct:		
Stocks Hypothecated	$624,000	
Stocks in safe	171,000	795,000.00
Balance, Stocks loaned		$1,705,000.00

The books and records of a stock broker differ very materially from those used by a trading or manufacturing concern, yet the accounts are in common, and the double entry principle is maintained throughout. It may safely be stated that stock brokers have not advanced in the lines of scientific bookkeeping as rapidly as have merchants and manufacturers, consequently the methods in use have been adhered to for many years. Of late, however, much improvement has been made along this line, and there are today numerous firms of brokers who have installed modern accounting systems. There is still a great variety of methods in use, and no two offices follow the same routine throughout. By an examination of the accompanying illustration one can see how the cash journal differs from the ordinary forms in use in other offices. In order to fully understand the accounting for stock brokers, the student should have a thorough knowledge of the broker's business, and of the many terms that are used therein. A special study of the subject should be made as an introductory step.

The broker's business is to buy and sell stocks and bonds for his customers, for which he gets a commission of 1/8 of one per cent both ways, for buying and again for selling. He sometimes speculates, that is, buys and sells for his own account in the hope of making a profit by the fluctuations of the market. His income is derived from commissions and from interest on money advanced for customers in the purchase of stocks. The amount of money thus advanced over and above the margins deposited by the customers usually draws interest at the prevailing rate. The expenses are not unlike those of any other office, with the exception of telegraph charges, which are usually quite heavy. Since the broker is constantly borrowing from his bankers it is evident that the interest account is likely to be an active feature in the running expenses of the business. The accounts usually required by stock brokers are included in the accompanying trial balance, but in many cases only part of them are used, and in some cases all expenses are included in the Expense Account, and all interest, whether given or received, in the Interest Account.

Books and Records.

The stock broker does a cash business, and therefore all transactions are recorded in the cash book, a form of which is shown herewith. This book is the main posting medium, and is variably known as Cash book, Cash journal, Day book, Blotter, Cashier's journal, etc. It is usually a large bound book with double pages; the left-hand pages contain the cash payments, and the right-hand the cash receipts. Two books are used alternately, one on Monday, Wednesday and Friday, and the other on alternate days. The cashier uses one for the day's transactions, while the bookkeeper uses the other. The form shown is common to most offices, with usually some modification in the use and location of columns. The principal books used are cash book, ledger and journal (the latter very little), and all others are auxiliary. The broker desires to know the amount of cash received and paid, the amount in bank, the amount and details of bank loans, the condition of his customers' accounts; which customers are "long" and which are "short," the condition of customers'

margin accounts under daily market fluctuations, the various securities on hand or hypothecated, and for whom held; the details of "short" sales and for whom made, the amount and kind of stocks borrowed or loaned, the daily purchases and sales, the interest and adjustments on customer's balances, the amount of gains and losses, etc. To supply this information there are various books and records used, nearly all of which are loose-leaf or cards, and specially ruled for the purpose. A trial balance is required monthly or oftener, and statements are rendered to customers monthly, quarterly or half-yearly. The customer is credited with his margin deposit and interest on same, also with sales of stock for his account; he is debited with all purchases of stock for his account and for commissions on purchases and sales, also, with interest on the amount advanced by the broker for the purchase of securities.

The Problem.

Since only cash transactions take place in a stock broker's office it will be seen from the illustration given that all of the entries have been put through the cash book. A journal entry might have been made for the exchange membership invested by B, instead of a cash book entry. The data presented shows the condition of the business at the end of the year, therefore no attempt has been made to go back of the information given. It is desirable to first make up the trial balance, and in so doing the cash book transactions are required. This necessarily involves a careful analysis of the entire problem, and to do so necessitates a knowledge of the stock broker's business. It would pay the reader to trace every transaction through the cash book and into the trial balance. It will be noticed that customers' accounts have been separated as between "long" and "short," and that "short" sales are credited to the customers. Credit is not always given for "short" sales, since the account presents a false condition under such a practice. Instead of this a credit memorandum in short is made to the customers' accounts and the amount of short sales credited to the "customers short" account.

Long and Short.

The broker is "long" of stocks when he has them in his possession, that is, when he has purchased stocks for his customers; he is "short" of stocks when he does not have them in his possession, that is, when he sells for account of customers who do not own the stocks, but expect to buy them at a lower quotation, thus realizing a profit on the decline of price. Since every sale of stock, however, requires an actual delivery, the broker must get the stock somewhere in order to complete the transaction for his customer. To make delivery he borrows temporarily (or rather buys, since the market values must be paid for them), from another broker and returns them as soon as the "short" has been covered, that is, as soon as he has bought said stock for his customer's account. When the broker is long of stocks, either his own or those belonging to customers, he may hypothecate them at the bank, loan them to other brokers or use them to complete "short" sales. When he loans stocks

it is equivalent to a temporary sale, as he receives the cash for same and usually pays a low rate of interest, but such loans are made subject to returns when called, either the same day or later. Most transfers are made through the Stock Exchange Clearing House, but space will not permit of a mention of its workings. The question states that stocks were borrowed and loaned to complete the transactions.

It will be seen in the problem that the "short" sales amount to $585,000, as recorded in the cash book and credited to customers. This necessitated the borrowing of an equivalent to make deliveries for which cash was paid. A charge was made to Borrowed Stock Account.

In the Stock Loan Account it will be seen that the "long" stocks amount to $2,500,000, but the problem states that only $171,000 of these remain on hand. What has become of the remainder? We see that $624,000 of said stock was hypothecated as security for bank loans, then the remaining stock, valued at $1,705,000, must have been loaned.

Problem No. 2.

A STOCK BROKERAGE firm composed of three partners agreed to dissolve Dec. 31, 1910.

The original investments contributed Jan. 2, 1910, were as follows:

A, cash, $100,000; B, cash, $150,000; C, $40,000; C's Capital Account was credited with $80,000, and his seat in the stock exchange held by the firm as collateral for the same.

The partnership agreement recites the following facts: A is allowed to withdraw $10,000 and charge same to expense; B is allowed to withdraw $15,000 and charge same to expense; C is allowed to withdraw $20,000 and charge same to expense.

Interest on partners' capital 5% per annum on original amount, profits or losses to be shared equally.

The interim transactions during the year as transcribed from the blotter were:

Purchases of 1,000 bonds, par value $1,000 each, for $1,005,000.00, maturing January 2, 1920.

Purchase of stock for customers, long, 50,000 shares (par value $100) for $4,750,000.

Sale of stock for customers, short, 50,000 shares (par value $100) for $4,625,000.

Margin reecived in cash from customers, long, $500,000.

Margin received in cash from customers, short, $500,000.

The following loans were made from banks on securities:

On bonds, $750,000; interest paid in full to Dec. 31, 1910, $32,500.

On stocks, $150,000; interest paid in full to Dec. 31, 1910, $6,000.

To complete transactions for account of customers all stocks were either borrowed or loaned.

The earnings comprised commissions $175,000 received in full; interest receivable $85,000, of which $70,000 was collected.

The expenses were $62,500 (exclusive of partners' allowances or interest paid on capital), of which $2,500 remained at time of dissolution.

The partners had withdrawn as follows: A, $16,500; B, $18,750; C, $18,500. The market value of the bonds was $1,004,500.

The Stock Exchange seat was finally sold to B for $85,000, the profit therefrom reverting to the firm.

Prepare statement, prior to dissolution, showing (a) Cash Receipts and Disbursements and balance on deposit in bank, (b) Income and Expenditures, (c) condition at time of dissolution, (d) partners' respective Capital Accounts.

Answer and Comments.

In working the problem the cash book has been used as the only posting medium, since in the offices of stock brokers it is the main book through which all entrties are posted. If desired, separate journal entries may be used for the various transactions in order to show them in proper sequence. Such entries could be studied in connection with the accompanying cash book as an aid to a better understanding of the subject. It will be seen that everything is placed in the cash book, and that amounts are shown on both sides thus supplying both debits and credits to the amounts involved. C's investment of $120,000 includes the stock exchange seat valued at $80,000. This was later sold to B for $85,000, thereby netting a gain of $5,000 to the firm. This sale is shown on both sides of the cash book, but in a case of scientific bookkeeping only such transactions as affect cash would be placed in the cash book, while all others would appear in the journal. The salaries and drawings of partners can be clearly understood from the records made. Interest on capital is included in the revenue statement as part of the profits for the year.

The interim transactions shown in the question evidently do not include all of the business transacted for the year. This is evidenced by the fact that the commission earned amounts to $175,000, which must have been computed on a much larger volume of business than is shown in the problem. The amount entered to customers short and customers long may or may not include the commissions, though it is customary to include commissions in the charges to long customers and to deduct them from the credits to short customers. In order to be on the safe side entries for commissions are omitted other than for the sum given. It seems evident, however, that the present customers have paid only margins and not commissions, and therefore should be charged for commission on the transactions shown, if said commissions have not already been included in the amounts given. If entries have not yet been made then $6,250 should be charged to short customers, and a like amount to long customers, with a corresponding credit to commission account.

Since the problem states that all stocks have been borrowed or loaned to complete transactions, it is assumed that all stocks for short sales have been borrowed in order to make delivery. On the other hand, all long stocks have been loaned to other brokers, less $187,500 assumed to have been hypothecated with the bank as security for loans. This is on the assumption that collateral loans are on a 20% margin, that is, that the amount loaned is 80% of the collateral hypothecated. The collateral account at this time should show only bonds on hand less amount hypothecated for bank loans.

Interest paid and received is shown on the respective sides of the cash book, omitting, of course, interest on capital as shown in the revenue account. Bond interest is assumed to be payable on July 1st and January 1st, the latter being payable on January 2d, due to the 1st being a holiday. On this presumption $25,000 is allowed for six months' interest accrued on bonds at five per cent.

The expenses incurred amount to $62,500, as shown in the cash payments, of which there is $2,500 still outstanding unpaid. In case this $2,500 is assumed to mean expense charges still on hand in the form of inventories, then the net profit would be increased by $2,500, and the cash balance decreased to the same extent, with a similar increase in capital. The bank account called for is equivalent to the balance shown by the cash book in case all moneys have been deposited. The statement of Income and Expenditures is very simple and will speak for itself. It will be noted that interest received and interest paid are placed on their respective sides of the statement in order to show the full transactions from interest account. It would not be wrong to place the balance of interest as a single item under Income.

The Statement of Assets and Liabilities is clear enough without further comment. It shows the firm's condition at time of dissolution.

The customers' accounts show only the transactions involved in the problem and including the interest charged to and paid by customers long. Short customers are not as a rule debited or credited with interest. The interest account is shown on a separate page, also the collateral account.

The partners' accounts are shown as on December 31st, exhibiting all of the transactions in connection with Investment, Withdrawals, etc.

Cash Statement for Year 1910.

Cash Receipts.

1910				
Jan. 2	A Capital	Cash Investment		$100,000.00
	B Capital	Cash Investment		150,000.00
	C Capital	Cash Investment	$40,000.00	
		Stock Exchange Seat	80,000.00	
				120,000.00
	Customers Short	Short sales		4,625,000.00
	Commissions	Transactions for Customers		175,000.00
	Collateral Loans	X Bank—Bond Securities		750,000.00
	Collateral Loans	Y Bank—Stock Securities		150,000.00
	Stock Loans	Customers Long Stks. loaned on street		4,562,500.00
	Customers Long	Cash Margins		500,000.00
	Customers Short	Cash Margins		500,000.00
	Interest Account	On Customers' Debit Balances		85,000.00
	Customers Long	Interest Collected		70,000.00
July 1	Interest Account	On Bonds Owned 6 mo. 5%		25,000.00
Dec. 31	Bond Account	Loss and Gain to mark bonds to Market Price		500.00
	Sund. Expenses Unpd.			2,500.00
	A Personal	Salary for Year		10,000.00
	B Personal	Salary for Year		15,000.00
	C Personal	Salary for Year		20,000.00
	Interest Account	Interest on Bonds 6 mo., 5%		25,000.00
	Stock Exchange Seat	Transferred to B		85,000.00
				$11,970,500.00
	Cash Balance			$1,115,250.00

Cash Payments.

Date	Account	Particulars		Amount
1910				
Jan. 2	Stock Exchange Seat	Contributed by C per Contract		$ 80,000.00
	Bond Account	$1,000,000, Bonds, Firm's Account		1,005,000.00
	Customers Long	Long Stocks Purchased		4,750,000.00
	Stocks Borrowed	Against Short Sales		4,625,000.00
	Interest Account	On Collateral Loans, Bonds.	$32,500.00	
		Stocks.	6,000.00	
				38,500.00
	Customers Long	Interest on Debit Balances		85,000.00
	Expense Account	Running Expenses		62,500.00
	Expense Account	Partners' Salaries—		
		A	$10,000.00	
		B	15,000.00	
		C	20,000.00	
				45,000.00
	A Personal	Drawings for year		16,500.00
	B Personal	Drawings for year		18,750.00
	C Personal	Drawings for year		18,500.00
Dec. 31	Loss and Gain	To Mark Bonds Down to Market Price.		500.00
	Int. Accrued on Bonds.	6 months, 5%		25,000.00
	B Capital	Stock Exchange Seat Transferred		85,000.00
Dec. 31—	Balance on deposit in bank			1,115,250.00
				$11,970,500.00

Income and Expenditures for Year Ended Dec. 31, 1910.

Income.

Commissions on Transactions for Customers			$ 175,000.00
Interest—Earned			135,000.00
Gain on Sale Stock Exchange Seat to B			5,000.00
Total Income			$ 315,000.00

Expenditures.

Running Expenses		$ 62,500.00	
Interest Paid on Call Loans		38,500.00	
Partners' Salaries:			
A for Year	$10,000.00		
B for Year	15,000.00		
C for Year	20,000.00		
		45,000.00	
Loss on Marking Bonds to Market Value		500.00	
Total Expenditures		146,500.00	
Net Profit Carried Down		168,500.00	
		$ 315,000.00	$ 315,000.00
Interest on Capital:			
A 5% on $100,000.00		5,000.00	
B 5% on 150,000.00		7,500.00	
C 5% on 120,000.00		6,000.00	
		$ 18,500.00	
Balance Net Profit for Distribution		150,000.00	

Distribution of Profits:

A ⅓Cr. to his account	$ 50,000.00
B ⅓ Cr. to his account	50,000.00
C ⅓ Cr. to his account	50,000.00
	$ 150,000.00

Balance Sheet, Dec. 31, 1910.

Assets.

Cash in Bank	$1,115,250.00
Bonds Owned—Market Value	1,004,500.00
Customers Long—Debit Balances on Stocks Carried	4,265,000.00
Interest Accrued on Bonds Owned	25,000.00
Total Assets	$6,409,750.00

Liabilities.

Collateral Loans:			
Bonds, X Bank	$ 750,000.00		
Stocks, Y Bank	150,000.00		
			$ 900,000.00
Stock Loans			4,562,500.00
Customers—Short Contracts:			
Credit Balance	$5,125,000.00		
Less Market Value Stocks	4,625,000.00		
Net Credit Balance			500,000.00
Sundry Expenses Unpaid			2,500.00
Total Liabilities			$5,965,000.00
A Capital Account			148,500.00
B Capital Account			118,750.00
C Capital Account			177,500.00
		$6,409,750.00	$6,409,750.00

Capital and Customers' Accounts.

Customers Long	Dr.	Cr.	Dr. Balance.	Cr. Balance.
Stocks Bought	$4,750,000.00			
Interest on Debit Balances	85,000.00			
Cash Margins		$500,000.00		
Interest Collected		70,000.00	$4,265,000.00	

Customers Short	Dr.	Cr.	Dr. Balance	Cr. Balance
Stocks Sold Short		$4,625,000.00		
Cash Margins		500,000.00		
Market Price Stocks Short	$4,625,000.00			$500,000.00

Note.—All previous commissions have been paid and are not shown in above accounts, and commissions on above items are assumed to have been included in the entries.

Interest Account	Dr.	Cr.	Dr. Balance	Cr. Balance
Interest on Collateral Loans..	$ 38,500.00			
Int. on Customers' Dr. Balances.		$85,000.00		
Int. on Bonds to July 1st......		25,000.00		
Int. on Bonds payable Jan. 2.. .		25,000.00		$ 96,500.00

Partners' Accounts, Dec. 31, 1910.

A CAPITAL.

Drawings	$ 16,500.00	Capital Invested	$100,000.00
Balance	148,500.00	Salary	10,000.00
		Int. on Capital..............	5,000.00
		1/3 Net Profit................	50,000.00
	$165,000.00		$165,000.00

B CAPITAL.

Drawings	$ 18,750.00	Capital Invested	$150,000.00
Stock Exchange Seat.........	85,000.00	Salary	15,000.00
Balance	118,750.00	Int. on Capital..............	7,500.00
		1/3 Net Profit................	50,000.00
	$222,500.00		$222,500.00

C CAPITAL.

Drawings	$ 18,500.00	Capital Invested	$120,000.00
Balance	177,500.00	Salary	20,000.00
		Int. on Capital..............	6,000.00
		1/3 Net Profit................	50,000.00
	$196,000.00		$196,000.00

AMALGAMATIONS AND MERGERS.

Problem No. 1.

THE CAMBRIA COMPANY was incorporated with a capital of $500,000, divided in 5,000 shares of $100 each, to take over the assets and liabilities of the firm of John Martin & Company and Charles Burton & Company.

John Martin and Henry Scott, his partner, each contributed $20,000 in cash to the company, and received in payment stock of the company at par.

Charles Burton and Thomas James, his partner, each contributed $15,000 in cash to the company, and received in payment stock of the company at par.

The net assets of the firm of John Martin & Company were purchased by the company at 75 per cent of their ledger values and full-paid stock of the company given therefor. The net assets of the firm of Charles Burton & Company were purchased by the company at 60 per cent of their ledger values and full-paid stock given by the company in payment therefor.

The condition of the ledger accounts of the vendors was as follows:

Assets and Liabilities of John Martin & Company.

ASSETS.		LIABILITIES.	
Cash	$ 5,000.00	Accounts Payable	$ 27,000.00
Real Estate (factory site)	15,000.00	Bills Payable	70,000.00
Machinery and Tools	7,500.00	John Martin, Capital Account.	18,000.00
Raw Stock, Lumber, etc.	1,000.00	Henry Scott	6,000.00
Raw Stock, Steel, Brass, Wire, etc.	8,000.00		
Good-Will	4,500.00		
Accounts Receivable	80,000.00		
	$121,000.00		$121,000.00

Assets and Liabilities of Charles Burton & Company.

ASSETS.		LIABILITIES.	
Raw Stock	$ 25,000.00	Chas. Burton, Capital Account.	$ 50,000.00
Manufactured Stock	20,000.00	Thomas James	150,000.00
Accounts Receivable	110,000.00		
Good-Will	45,000.00		
	$200,000.00		$200,000.00

It was agreed that all the assets and liabilities acquired by purchase should appear upon the books of the company at the values shown in vendors' ledgers until the close of the third year, at which time good-will should be charged to profit and loss account. And it was stipulated that in the event of the legitimate profits of any year from trading exceeding $20,000, the individual members of the firm of Charles Burton & Company were to receive 30 per cent excess, and expense account be charged therewith, but if the profits were less than $20,000 they were to pay the deficiency to the company and expense account be credited therewith.

The profit and loss account showed legitimate profits from trading, for the first year, amounting to $27,000; for the second year $40,000, and for the third year $15,000, before adjusting the claims arising from above stipulation as to the $20,000. The entire profits, irrespective of their source, were then paid to stockholders of issue as dividends in full-paid stock.

Submit statement as follows:

(a) Give aggregate of net assets at the close of the first, second and third years, assuming all debts to have been paid.

(b) Give the amount due to each of the parties in interest in stock and undivided profits at the end of the first and second years respectively, assuming profit and loss accounts as being adjusted at these periods, and the amount of stock held by each stockholder after the actual adjustment of the profit and loss and dividend accounts, at the end of the third year.

(c) Use given assets and liabilities throughout, with an additional account entitled "Increase," and submit balance sheets for the close of each period.

Entries on Cambria Company's Books.

Subscription	$70,000.00	
To Capital Stock		$70,000.00

The Cambria Company has been incorporated with an authorized capital of $500,000; 5,000 shares of $100 each. It is agreed that the assets and

liabilities of the firm of John Martin & Company and Charles Burton & Company are to be taken over in payment for stock.

Cash subscriptions have been received as follows:

John Martin, 200 shares	$ 20,000.00	
Henry Scott, 200 shares	20,000.00	
Charles Burton, 150 shares	15,000.00	
Thomas James, 150 shares	15,000.00	
Cash	$ 70,000.00	
To Subscription		$ 70,000.00

For payment of subscriptions shown above.

Cash	$ 5,000.00	
Real Estate	15,000.00	
Machinery and Tools	7,500.00	
Raw Stock—Lumber, etc	1,000.00	
Raw Stock—Steel, brass, wire, etc	8,000.00	
Good Will	4,500.00	
Accounts Receivable	80,000.00	
To Accounts Payable		$ 27,000.00
To Bills Payable		70,000.00
To John Martin & Company		18,000.00
To Contingent Account		6,000.00

For assets and liabilities of John Martin & Company purchased this day in exchange for full paid stock of the company.

The net assets, $24,000.00, are taken over at 75 per cent of their ledger values, or $18,000.00, as per agreement.

John Martin & Company	$ 18,000.00	
To Capital Stock		$18,000.00

For 180 shares of stock issued to John Martin & Company for net assets of firm, as per agreement, and divided in proportion to respective interests:

John Martin, 135 shares	$ 13,500.00	
Henry Scott, 45 shares	4,500.00	
		$ 18,000.00

Raw Stock	$ 25,000.00	
Manufactured Stock	20,000.00	
Accounts receivable	110,000.00	
Good Will	45,000.00	
To Charles Burton & Company		$120,000.00
To Contingent Account		80,000.00

For assets of Charles Burton & Company purchased at 60 per cent of their par value, in exchange for full paid stock.

Charles Burton & Company	$120,000.00	
To Capital Stock		$120,000.00

For 1,200 shares of stock issued for net assets, as per agreement, divided in proportion to respective interests:

Charles Burton, 300 shares	$ 30,000.00	
Thomas James, 900 shares	90,000.00	

There are still 2,920 shares of stock of the company unsubscribed, to be disposed of at the will of the directors.

End of First Year:

Increase in Assets	$ 27,000.00	
To Profit and Loss		$27,000.00

For Profits on trading for year entered to "Increase" as per agreement.

Profit and Loss	$ 2,100.00	
To Charles Burton & Company		$ 2,100.00

For portion of profits allowed to Charles Burton & Company per agreement, it being 30 per cent of $7,000, the excess of profits over and above $20,000, the stipûlated amount.

Profit and Loss	$ 24,900.00	
To Undivided Profits		$ 24,900.00

For unapportioned profits held for future disposition.

Accounts Payable	$ 27,000.00	
Bills Payable	70,000.00	
To Cash		$ 97,000.00

For payment of outstanding debts.

End of Second Year:

Increase in Assets	$ 40,000.00	
To Profit and Loss		$ 40,000.00

Profits on trading for year.

Profit and Loss	$ 6,000.00	
To Charles Burton & Company		$ 6,000.00

For portion of profits allowed to Charles Burton & Company.

Profit and Loss	$ 34,000.00	
To Undivided Profits		$ 34,000.00

Balance of profits held for future disposition.

End of Third Year:

Increase in Assets	$ 15,000.00	
To Profit and Loss		$ 15,000.00

Profit on trading for year.

Charles Burton & Company	$ 5,000.00	
To Profit and Loss		$ 5,000.00

For deficiency in profits paid by Charles Burton & Company by agreement.

Profit and Loss	$ 49,500.00	
To Good Will		$ 49,500.00

Good-Will charged off as loss, as per agreement.

Contingent Account	$ 86,000.00	
To Profit and Loss		$ 86,000.00
Undivided Profits	$115,100.00	
To Capital Stock		$115,100.00

Entire amount of undivided profits for three years, less $300, being uneven amounts paid in stock to stockholders of issue in stock of the company, per dividend apportionment.

Burton & Company	$ 3,100.00	
To Cash		$ 3,100.00

For settlement of account per agreement.

Allowance from Assets purchased at beginning, apportioned to profits per agreement.

Profit and Loss	$ 56,500.00	
To Undivided Profits		$ 56,500.00

For Balance of Profits for disposition.

Profit and Loss Account.

First Year			
To Expense 30 per cent of Excess Profits, $7,000, given to Charles Burton & Company.	$ 2,100.00	By Net Profits	$ 27,000.00
Balance, Undivided Profits	24,900.00		
	$ 27,000.00		$27,000.00

Profit and Loss Account.

Second Year			
Total Expense 30 per cent of Excess Profits, 20,000, given to Charles Burton & Company.	$ 6,000.00	By Net Profits	$ 40,000.00
Balance Undivided Profits	34,000.00		
	$ 40,000.00		$ 40,000.00

Profit and Loss Account.

Third Year			
To Good-Will	$ 49,500.00	By Net Profits	$ 15,000.00
" Bal., Undivided Profits	56,500.00	" Expense Deficiency in profits paid by Charles Burton & Company.	5,000.00
		By Contingent Account	86,000.00
	$106,000.00		$106,000.00

Undivided Profits.

To Capital Stock John Martin, 185 shares Henry Scott, 135 shares Chas. Burton, 249 shares Thos. James, 582 shares	$115,100.00	First Year Second Year Third Year	$ 24,900.00 34,000.00 56,500.00
To Balance Uneven Amounts due to stockholders.	300.00		
	$115,400.00		$115,400.00
		By Balance	$ 300.00

Comparative Balance Sheet for Three Years.

ASSETS	At Beginning	First Year	Second Year	Third Year
Cash	$ 75,000.00	$ 75,000.00	$ 75,000.00	$ 75,000.00
Real Estate	15,000.00	15,000.00	15,000.00	15,000.00
Machinery and Tools	7,500.00	7,500.00	7,500.00	7,500.00
Raw Stock	34,000.00	34,000.00	34,000.00	34,000.00
Manufactured Stock	20,000.00	20,000.00	20,000.00	20,000.00
Accounts Receivable	190,000.00	190,000.00	190,000.00	190,000.00
	$341,500.00	$341,500.00	$341,500.00	$341,500.00
Add Increase		27,000.00	67,000.00	82,000.00
		$368,500.00	$408,500.00	$423,500.00
Less Debts Paid		97,000.00	97,000.00	97,000.00
		$271,500.00	$311,500.00	$326,500.00
Due Charles Burton & Company		2,100.00	8,100.00	3,100.00
Net Assets	$341,500.00	$269,400.00	$303,400.00	$323,400.00
Good-Will	49,500.00	49,500.00	49,500.00	
Total	$391,000.00	$318,900.00	$352,900.00	$323,400.00

LIABILITIES	Beginning	First Year	Second Year	Third Year
Debts Owing	$ 97,000.00			
Capital Stock Paid Up	208,000.00	$208,000.00	$208,000.00	$323,100.00
Contingent Account	86,000.00	86,000.00	86,000.00	
Undivided Profits		24,900.00	58,900.00	300.00
	$391,000.00	$318,900.00	$352,900.00	$323,400.00

Profits Apportioned to Stockholders.

NAMES	First Year	Second Year	Third Year	Total
John Martin	$ 4,010.34	$ 5,475.96	$ 9,099.76	$ 18,586.06
Henry Scott	2,932.93	4,004.81	6.655.05	13,592.79
Charles Burton	5,387.02	7,355.77	12,223.56	24,966.35
Thomas James	12,569.71	17,163.46	28,521.63	58,254.80
	$ 24,900.00	$ 34,000.00	$ 56,500.00	$115,400.00

Stockholders' Accounts at End of Third Year

NAMES	Acquired For cash	Old Business	Dividends	Total Shares	Remarks
John Martin	200	135	185	520	From Capital Stock
Henry Scott	200	45	135	380	" " "
Charles Burton	150	300	249	699	" " "
Thomas James	150	900	582	1632	" " "
	700	1380	1151	3231	" " "
Unsubscribed Shares				1769	
				5000	

Comments.

This proposition has been selected for the purpose of illustrating the procedure in the incorporation of going concerns. Because of its peculiarly interesting requirements and the difficulty in interpreting them, there may be a variance in answers; nevertheless, bookkeepers and accountancy students will find it ample food for thought. Before working out a question like this, the main requirements should be noted and a carefully outlined plan of procedure mapped out. This will prevent repetitions or haphazard work.

Journal entries are made for the entire three years in order to show more clearly the methods of arriving at results; and in studying the problem students are advised to open ledger accounts as a means of exhibiting the condition thereof at the end of each period. As will be noticed, an account for unsubscribed stock has been omitted. This is done for the purpose of varying from the plan shown in some other solutions, and for the purpose of exhibiting net assets with the least inconvenience. Since the assets and liabilities are to remain at their original valuation, during the entire three years, the Balance Sheet has been arranged with that end in view. Such a condition would hardly occur in actual business, as accounts would constantly be changing; yet this is a plan suggested by the examiners in testing the candidate's ability to analyze. Fluctuations are adjusted into an Increase account as instructed. It is assumed that Bills and Accounts Payable were paid during the first year, and that the profit allowances to Charles Burton & Company are adjusted and paid at the end of the third year, at which time $3,100 was paid in cash. The discount on assets taken over may be credited to Contingent Account, to Discount on Assets, to Suspense, or to some other similar account, and at the time of final adjustment it is apportioned to profits as suggested in the problem. The undivided profits are all carried until the end of the third year and then paid to stockholders in proportion to holdings, omitting, of course, fractional parts of shares. Good-will is deducted in getting the net assets, but if thought advisable it may be included. Since it is to be written off as a loss, however, the omission seems advisable.

The forms presented may be varied to suit individual tastes without loss of effect. The combined balance sheet is made to include the assets and liabilities at the beginning. The unpaid profits due to stockholders, $300, being fractional parts of shares, are held subject to the will of the directors.

Problem No. 2.

THE FOLLOWING is abstracted from an agreement of merger and consolidation made December 31, 1912, between the Pennsylvania Tool Co., party of the first part, and the Keystone Tool Co., party of the second part. Said parties of both parts being corporations duly organized and existing under the laws of the State of Pennsylvania, by this agreement merge and consolidate into a single corporation.

The name of the corporation hereby formed by said consolidation shall be the Pennsylvania Tool Co.

The amount of capital stock of the new corporation is $100,000, all of which shall be common stock, divided into 1,000 shares of a par value of $100. The manner of distributing capital stock shall be as follows:

The capital stock of the Pennsylvania Tool Co., party of the first part, shall be exchangeable for capital stock of the new corporation share for share, and the balance of the capital stock of the new corporation hereby formed shall be distributed to the stockholders of the Keystone Tool Co. in proportion to their present holdings.

The Pennsylvania Tool Co., party of the first part, was incorporated shortly before the date of the merger, and had transacted no business other than the issuance of ten shares capital stock, $100 each, for which payment of $1,000 had been received, and which was on hand in the treasury of the company on the date of the merger, and directly after the merger transferred to the bank deposit account of the consolidated company and credited to an account called "Suspense."

The Keystone Tool Co. had for a number of years been actively engaged in business. Its fiscal year ended September 30, 1912, at which time an inventory was taken and its accounts had been properly closed. At the date of the merger the following trial balance was drawn from the books.

Trial Balance Dec. 31, 1912.

	Debit.	Credit.
Cash	$ 20,000.00	
Accounts Receivable	15,000.00	
Merchandise—Inventory Sept. 30, 1912	130,000.00	
Merchandise purchases	250,000.00	
Expenses	25,000.00	
Accounts Payable		10,000.00
Sales		300,000.00
Capital Stock		30,000.00
Undivided Profits—Balance Sept. 30, 1913		100,000.00
	$440,000.00	$440,000.00

The account books of this concern were not closed at the date of the merger, and no inventory was taken, although the exchange of capital stock was effected and also all business after December 31, 1912, was transacted under the name of the Pennsylvania Tool Co., and it was not until March 31, 1913, that an accountant was asked to state the accounts of the new company from the date of consolidation.

At March 31, 1913, before the accountant had commenced his work, an inventory was taken which showed the value of merchandise on hand as at that date to be $216,250, and the following Trial Balance was abstracted from the books:

Trial Balance, March 31, 1913.

	Debit.	Credit.
Cash	$ 26,000.00	
Accounts receivable	10,000.00	
Merchandise inventory, Sept. 30, 1912	130,000.00	
Merchandise purchased	600,000.00	

Expenses	60,000.00	
Accounts payable		$ 10,000.00
Sales		685,000.00
Suspense		1,000.00
Capital Stock		30,000.00
Undivided Profits		100,000.00
	$826,000.00	$826,000.00

Prepare a Balance Sheet of the consolidated company as at March 31, 1913, and a profit and loss account arranged to show the profits of the consolidated company for the three months ended March 31st; and of the Keystone Tool Co., for the three months ended December 31st; also statement showing the disposition of profits taken over by the new company.

State what basis you make use of in determining the approximate value of merchandise on hand December 31st.

Comments.

In the question under review the requirements are as follows: (1) Balance Sheet of the consolidated company on Mar. 31, 1913; (2) Profit and Loss Account for the consolidated company for the three months ended Mar. 31, 1913; (3) Profit and Loss Account of the Keystone Tool Company for the three months ended Dec. 31, 1912; (4) Statement showing disposition of profits taken over by the new company; (5) Basis of determining the approximate value of merchandise on hand Dec. 31, 1912. Adjusting journal entries might also be of advantage in providing a clearer exhibit of the necessary adjustments.

Let us now get a clear insight into the problem. Two separate corporations—The Pennsylvania Tool Co. and the Keystone Tool Co.—are to consolidate and transact business hereafter as a single concern, and to be known as The Pennsylvania Tool Co. The capital stock of the consolidated company is to be $100,000—1,000 shares of $100 each. We will now look into the proposition from the standpoint of each company separately.

The Pennsylvania Tool Co.: This company had just been incorporated, and evidently had not begun operations. Its authorized capital stock is not given, but $1,000 has been subscribed and paid in, and is still in the treasury. This amount is to be turned over to the new company and credited to a Suspense account, and an equal amount of the new company's stock received. It is, no doubt, credited to this account temporarily with the thought of having a proper adjustment later.

The Keystone Tool Co.: This is an established company, and its fiscal year ended Sept. 30, 1912. It has a capital stock of $30,000, and a surplus of $100,000, making a total capital of $130,000. On Dec. 31, 1912, the consolidation took place, the exchange having been effected on the basis of accounts shown by the Trial Balance of that date without closing the ledger. By the terms of the amalgamation the stockholders of this company are to have all of the stock but $1,000, and will receive certificates for $99,000 in exchange for $30,000 of the stock of the old company. This is an increase of $69,000.

It will be seen that the capital and surplus of the Keystone Company amount to $100,000 on Sept. 30, and that on Dec. 31st, they have increased to $180,000. The increase of capital from $30,000 to $99,000 may be adjusted into surplus as shown in the accompanying statements, or the $69,000 may be charged to good will account. If the latter plan is followed the Surplus on Jan. 1, 1913, will show a credit of $150,000, and on April 1, $211,250. Either plan may be followed. In the former plan the Keystone Company turns over a Surplus of $81,000 over and above the amount of stock received. This is now owned by the consolidated company, but as the stockholders in the former company own practically all of the stock of the new and amalgamated company they are not losing anything by making the liberal donation of surplus profits. Except for the purpose of reorganizing and increasing its capital stock, or possibly for the purpose of changing its name, no gain will accrue to the Keystone Company by the so-called merger and consolidation. It could have declared a special stock dividend payable out of surplus profits and have provided for same by an increase of capital stock.

Determining Value of Inventory.

The question asks for an approximate valuation of inventory as on Dec. 31, 1912. The first step, as shown by Exhibit A, is to determine the gross gain for the entire six months ended Mar. 31, 1913, which amounts to $171,250. It will be noted that this gain is just one-fourth of the sales or one-third of the cost of goods sold; therefore we may consider the gains for the first three months as having been in the same proportion. The sales for the three months ended Dec. 31, 1912, were $300,000, and if one-fourth of this amount represents profits the cost of goods sold must have been $225,000. Deduct this amount from $380,000, the cost of all goods to that date, and we get $155,000, or the value of merchandise on hand. By adding together the gross gain in Exhibits B and D it will be seen that they equal the amount shown by Exhibit A, $171,250.

The various exhibits are easily understood and, therefore, need no special comments. The surplus account is included for the purpose of showing the disposition of profits taken over from the Keystone Tool Company. It is presumed that the books formerly used by the Keystone Company are contined, and the adjusting entries which follow are made on that presumption. The various official steps required in the consolidation of the two corporations, the transfer of assets and liabilities, etc., would have to be carried out to the letter. These steps would not vary to any great extent from those required in the amalgamation of two unincorporated concerns into one corporation, as outlined in another problem.

Adjusting Entries, March 31, 1913.

(Made on the various dates indicated, omitting the usual routine entries).

December 31, 1912.

Cash	$ 1,000.00	
To Suspense		$ 1,000.00
For amount of cash turned over by Pennsylvania Company, per agreement this day.		

Profit and Loss	50,000.00	
To Surplus		50,000.00
Transfer of Profits of Keystone Tool Co.		
Surplus	69,000.00	
To Capital Stock		69,000.00
For transfer of surplus profits to capital account for account of Keystone Tool Co., per agreement.		
Suspense	1,000.00	
To Capital Stock		1,000.00
For transfer of amount credited to Suspense Account.		

March 31, 1913.

Profit and Loss	62,250.00	
To Surplus		62,250.00
For transfer of net gain for three months to surplus account.		

EXHIBIT A.

Merchandise Account to March 31, 1913.

DEBITS.		CREDITS.	
Inventory, 9-30-12	$130,000.00	Total Sales for 6 months	$685,000.00
Purchases	600,000.00		
Total	$730,000.00		
Less—			
Inventory, 3-31-13	216,250.00		
Cost of Sales	513,750.00		
Gross Gain	171,250.00		
	$685,000.00		$685,000.00
		Balance, Gross Gain	$171,250.00

Note.—This exhibit is made as a basis of determining the value of the goods on hand Dec. 31, 1912, as explained in comments.

EXHIBIT B.

Keystone Tool Company.

Trading and Profit and Loss Account Dec. 31, 1912.

DEBITS.		CREDITS.	
Inventory, 9-30-12	$130,000.00	Sales for three months	$300,000.00
Purchases	250,000.00		
Total	$380,000.00		
Less Inventory, 12-31-12	155,000.00		
Cost of goods sold	225,000.00		
Gross Gain	75,000.00		
	$300,000.00		$300,000.00
Expenses	$ 25,000.00	Gross Gain brt. down	$ 75,000.00
Net Gain	50,000.00		
Carried to Suspense Acct.	$ 75,000.00		$ 75,000.00

EXHIBIT C.

Keystone Tool Company.

Balance Sheet, Dec. 31, 1912.

ASSETS.		LIABILITIES.		
Cash on hand	$ 20,000.00	Accounts Payable		$ 10,000.00
Accounts Receivable	15,000.00	Capital Stock		30,000.00
Goods on Hand	155,000.00	Surplus, 3-30-12	$100,000	
		Add net gain	50,000	150,000.00
	$190,000.00			$190,000.00

Note.—This exhibit shows the condition of the company at the time of consolidation. The capital and surplus of $180,000.00 is given in exchange for $99,000.00 of stock of the new company.

EXHIBIT D.

Pennsylvania Tool Company.

Trading and Profit and Loss Account, 3 months ended March 31, 1913.

DEBITS.		CREDITS.	
Inventory, 1-1-13	$155,000.00	Sales for 3 months	$385,000.00
Purchases	350,000.00		
	$505,000.00		
Less Inventory 3-31-13	$216,250.00		
Cost of goods sold	$288,750.00		
Gross Gain	96,250.00		
	$385,000.00		$385,000.00
Expenses	$ 35,000.00	Gross Gain brt. down	$ 96,250.00
Net Gain	61,250.00		
Carried to Surplus	$ 96,250.00		$ 96,250.00

Note.—The above net gain is carried to Surplus account to await the will of the directors. If the fiscal year is to remain as before, then the period has arrived for the semi-annual dividend.

EXHIBIT E.

Pennsylvania Tool Company.

Consolidated Balance Sheet, March 31, 1913.

ASSETS.		LIABILITIES.		
Cash on hand	$ 26,000.00	Accounts Payable		$ 10,000.00
Goods on hand	216,250.00	Capital Stock		100,000.00
Accounts Receivable	10,000.00	Penna. Tool Co.	$ 1,000	
		Keystone Tool Co.	99,000	
		Surplus		142,250.00
		Acquired	$81,000	
		Earned	61,250	
	$252,250.00			$252,250.00

Note.—If good will had been considered for the increase of stock of the Keystone Tool Co., then good will $69,000.00 would appear among the assets and Surplus would be increased to $211,250.00.

EXHIBIT F.
Surplus Accounts.

To capital per adjustment, 12-31-12	$ 69,000.00	Balance 9-30-12	$100,000.00
Balance	142,250.00	Added 12-31-12	50,000.00
		Added 3-31-13	61,250.00
	$211,250.00		$211,250.00
		Balance 4-1-13	$142,250.00

Note.—The term Undivided Profits, as used in the question, may be used instead of Surplus. If good will had been considered, the present balance to surplus account would be increased by $69,000.00.

BUILDING AND LOAN ASSOCIATIONS.

THE FOLLOWING question has been selected as the basis for a discussion on Building and Loan Associations, but in order to enlarge more fully than this problem permits, the accompanying report of a Philadelphia association is made use of.

Question.

The Wayne Building and Loan Association has been incorporated under the laws of Pennsylvania, April 2, with the authorized capital of $1,000,000. Stock divided into two classes, full paid stock and installment stock, par value of each $100 per share. Monthly payments on installment stock to be sixty cents per share per month, of which ten cents per share may be devoted to operating expenses, etc. No part of the profits can be used for expenses of the association. Estimated time of the maturity of the installment stock based on the earning power of the loaning feature of the association is 110 months.

The directors decide to advance $1,000 each (nine directors) for the creation of a fund to develop the business, and ten per cent of the expense deductions to be set apart each year for the repayment of this nine thousand dollars. The secretary reports the sale of 1,000 shares of the installment stock on which the first month's payment of sixty cents has been made; he also reports the sale of 500 shares of full paid stock for which he received the money.

Give the proper books for conducting the business of this association and for keeping its accounts, and make the opening entries from the above facts.

Opening Entries.

The entries for the question given are few and would be contained in the Minute Book, Cash Book, Stock Certificate Book, General Ledger, and Individual Ledger. A Journal is seldom used, but in this case the entries are given in journal form. The usual formalities of filing Articles of Association with the State are carried out, and letters patent issued. The organization then takes place, by-laws are adopted, business transacted, etc., and minutes of proceedings written up. The usual organization expenses are required, but as they are not called for in the question no attempt will be made to estimate them. The entries are:

April 2.

Cash	$ 9,000	
To Development Fund		$ 9,000
Advancement of $1,000 each from the nine directors for the creation of a fund to develop the business.		
Cash	600	
To Installment Stock		600
For subscription of 1,000 shares of installment stock at 60 cents and payment of first month's dues thereon.		
Cash	50,000	
To Full Paid Stock		50,000
For sale of 500 shares of full paid stock.		

Annual Report of an Association

RECEIPTS.

Cash on hand at last report	$ 2,169 55
Dues	69,795 50
Interest	21,753 93
Interest from Land Title & Trust Co. (balance)	34 06
Interest from Union National Bank (balance)	354 59
Fines	171 75
Printing Assessments	284 31
Loans returned by Borrowers	28,100 00
Loans canceled by maturity of 22nd series	5,250 00
Rent from Real Estate	114 00
Money Borrowed	56,500 00
	$184,527 69

DISBURSEMENTS.

210 shares 22nd Series matured and paid off in cash	$42,000 00
Withdrawals	22,744 47
Mortgage Loans made during Term	53,400 00
Stock Loans made during Term	19,800 00
Expenses: Salaries, Advertising, Books, Stationery, Rent of Hall, etc.	1,959 12
Real Estate Expenses, Taxes and Water Rent	107 82
Interest on Borrowed Money	716 17
Borrowed money returned	40,500 00
Balance in Treasury	3,300 11
	$184,527 69

ASSETS.

Investments in Loans at last report		$341,700 00
Investments during Term		73,200 00
		$414,900 00
Deduct:—		
Loans returned by Borrowers	$28,100 00	
Loans canceled by maturity of 22nd Series	5,250 00	
		$33,350 00
		$381,550 00
Arrears due by members	$618 26	
Less amounts overpaid	173 00	
		445 26
Real Estate		6,000 00
Interest accrued on Special Loan		375 00
Balance in Treasury		3,300 11
		$391,670 37
Deduct:—		
Money borrowed at end of Term		18,000 00
		$373,670 37

LIABILITIES.

Series.	Sh'r's	Months	Total Paid in	Value Per Share	Total Value
23d	342	132	$45,144	185 85	$63,560 70
24th	289½	120	34,740	164 51	47,625 65
25th	294½	108	31,806	144 05	42,422 73
26th	257	96	24,672	124 48	31,991 36
27th	309½	84	25,998	105 80	32,745 10
28th	411¼	72	29,610	88 02	36,198 23
29th	422	60	25,320	71 12	30.012 64
30th	481½	48	23,112	55 12	26,540 28
31st	683¾	36	24,615	40 00	27,350 00
32d	909½	24	21,828	25 78	23,446 91
33d	945	12	11,340	12 45	11,760 62
					$373,654 22
				Undivided	16 15
	5,345½		$298,185		$373,670 37

Profit on Present Shares		$75,485 37
Add profit paid during Term—		
To matured 22d Series	$12,390 00	
To withdrawals	1,787 47	
		14,177 47
		$89,662 84
Deduct profits to end of previous Term		69,676 18
Profits for Term ending September,		$19,986 66

Profits to Association to September,		$69,676 18
Deduct Amount of Profit paid since:—		
To matured 22d Series	$12,390 00	
To withdrawals	1,787 47	
		14,177 47
		$55,498 71
Profits, for year ending September,		19,986 66
Profits on present Shares		$75,485 37

	I	II.	III.	IV.	V.	VI.	VII.
SERIES	Number of Shares Beginning of Term	Number of Shares Loaned on Beginning of Term	Number of Shares Loaned on During Term	No. of Shares Loaned on, Withdrawn, and Loans returned During Term	Number of Shares Loaned on at End of Term	Total Number of all Shares Withdrawn During Term	Total Number of all Shares Remaining at End of Term
Twenty-second...	210	25	1½	26½		210	
Twenty-third.....	342	129¾	13¾	6	137½		342
Twenty-fourth....	292½	56	13½	2	67½	3	289½
Twenty-fifth.....	314½	102½	19¼	5	116¾	20	294½
Twenty-sixth.....	281½	50	7¾	15½	42¼	24½	257
Twenty-seventh..	314½	99	14¼	3	110¼	5	309½
Twenty-eighth....	459¼	182½	9¼	7	184¾	48	411¼
Twenty-ninth....	489	181¼	17½	22¼	176½	67	422
Thirtieth........	534½	141½	6¾	29½	118¾	53	481½
Thirty-first......	805¾	271½	8	33½	246	122	683¾
Thirty-second....	1041	319½	34¾	12¾	341½	131½	909½
	5084½	1558½	146¼	163	1541¾	684	4400½
Thirty-third......	1137		219¾	3¾	216	192	945
Total............	6221½	1558½	366	166¾	1757¾	876	5345½

Explanation—Shares in Column VI. deducted from those in Column I., leave as results shares in Column VII. Shares in Column IV. deducted from those in Columns II. and III., added together, leave as a result number of shares in Column V.

Comments.

Philadelphia Associations make reports similar to the one shown herewith, though many of them include additional information for the benefit of stockholders. This one, however, may be taken as a typical report. It will be noticed that there are three divisions to the report, namely, the cash statement, the statement of assets and liabilities, and the analyzed exhibit of the various series. Sometimes additional exhibits are included (and were on the back of the report selected), showing the profit and loss account, the numbers of books in arrears with amounts, books paid in advance, analysis of loans, etc.

Cash Statements.—It will be noticed that the cash receipts for the year are $182,358.14 and the disbursements $181,227.58, leaving a balance in the hands of the treasurer of $3,300.11. Among the receipts we can see the various sources of income, also a record of money borrowed, amounting to $56,500. Among the disbursements we can see the various demands for expenses, withdrawals, interest, etc., including the repayment of $40,500 of borrowed money.

Assets and Liabilities.—Among the liabilities we have an analyzed statement of the various series showing the amount paid in on each, also the present status of each series, after apportioning profits. This shows to each stockholder in any series, according to shares held, the amount that he has paid in, the amount of profits credited, and the present book value of his shares. Among the assets are loans of $414,900, which include loans on both real estate and association stock; from this is deducted loans canceled during the year, leaving the present balance in the loan account $381,550. Real estate on hand was no doubt received by foreclosure of loans. Loans payable in the form of notes due the bank are $18,000, which amount is shown deducted from the assets in order not to affect the status of the liabilities to members. In order to simplify this statement it has been rearranged in the form of a balance sheet which should be studied in connection with the report.

Information regarding the adjustments of profits is given immediately under the statement of assets and liabilities and is worthy of careful study. The profits apportioned for the present year, $19,986.66, is the balance after taking credit for earnings and for profits forfeited by withdrawing members, less expense, interest, etc.

Analysis of Series.—The columnar exhibit of the various series is worthy of careful study, as it contains an analysis of stock outstanding at the beginning of the year plus the new series issued, minus withdrawals. It also shows the shares loaned upon and those remaining free.

Balance Sheet, Rearranged.

ASSETS.

Real Estate Loans—		$381,550.00
Association Stock Loans—		
Real Estate		6,000.00
Interest Accrued		375.00
Cash on Hand		3,300.11
Dues in Arrears	$ 618.26	
Less dues prepaid	173.00	445.26
		$391,670.37

LIABILITIES.

Dues paid in		$298,185.00
Add Earnings Previous Year	$55,498.71	
This year	19,986.66	75,485.37
Value of all shares		373,670.37
Notes payable		18,000.00
		$391,670.37

Distribution of Profits.

The most difficult part of building association accounting is the manner of distributing profits among the various series of stock. Of course, the members of each series have equal amounts per share to their credits, therefore the amount of profits apportioned to a series divided by the number of shares therein will give the profits to be added to each share. In the report given the total payments by members is $298.185 and the profits amounting to $75,485.37 have been equitably distributed to the various series on the basis of payments giving an aggregate credit to members of $373,654.22, with $16.15 left over. How has the $75,485.37 been distributed? It will be seen that the profits for the present year are $19,986.66. Now, if the profits for each year were credited to the various series and permitted to remain there, there would be only the profits for this year, $19,986.66, to be apportioned and added thereto. This plan, however, is not always followed, as many associations carry the aggregate profits in one account and at the end of each year estimate for the purpose of making

annual report or for settling with matured shares the portion of such aggregate belonging to each series. This consists of an annual apportionment of all accumulated profits, it being the plan followed by the secretary of the association under discussion.

There are various ways of distributing profits but the "partnership" plan used by this association is considered the most equitable by Pennsylvania courts. Take a share of the last series, 33rd, on which $12 has been paid, give it a gaining power of 1. Now take a share in the 32nd series which has twice the value and has been invested twice as long, and give it a gaining power of 2x2=4. The 31st series has three times the status of the first and has a gaining power of 3x3=9. This plan of estimating is continued up to the oldest series, 23rd, which has paid in 11 times $12 or $132, and therefore has a gaining power of 11x11 or 121. Now multiply the gaining power of each series by the number of shares therein:

33d series, 945 shares by 1 =	945
Other series omitted.	.....
23d series, 342 shares by 121 =	41,382
Total of all series..........	169,595¾

To find the gain per share for the 33rd or unit series divide the total gains by the amount gotten by multiplying the various gaining powers with the shares in series, as $75,485.37 ÷ 169,595¾ = 44.51 cents (nearly) per share. In this series the value of one share is the dues plus profits, $12 plus .4451 = $12.4451 ($12.45 shown in the report), giving a total value of all shares in the series of $12.4451 times 945, or $11,760.62. In series 32 the profits per share are found by using the gaining power of the series, as .4451 times 4 is $1.7804, giving a total value of all shares therein of 25.7804 times 909½ or $23,446.91. This method is followed through the various series as shown in the accompanying exhibit headed "Apportionment of Profits." By adding together the dues paid in on a share or series and the profits apportioned to it the total or book value thereof is obtained. A further elucidation of the methods of dividing profits could be given but a careful study of the exhibits will enable one to grasp the ideas intended to be conveyed.

Apportionment of Profits

Series	Shares	Mos.	Total	Gaining Power	Total	Gain per Share	Value	Total Value
23	342 ×	132 =	$45154	121 =	41382	53.85	See report	See report
24	289½ ×	120 =	34740	100 =	28950	4.51		
25	294½ ×	108 =	31806	81 =	23854½	36.05		
26	257 ×	96 =	24672	64 =	16448	28.48		
27	309½ ×	84 =	25998	49 =	15165½	21.80		
28	411¼ ×	72 =	29610	36 =	14805	16.02		
29	422 ×	60 =	25320	25 =	10550	11.12		
30	481½ ×	48 =	23112	16 =	7706	7.12		
31	683¾ ×	36 =	24615	9 =	6153¾	4.00		
32	909½ ×	24 =	21828	4 =	3638	1.78		
33	945 ×	12 =	11340	1 =	945	.4451		
	5345½		$298195		169597¾			

EXECUTORS AND TRUSTEES.

JAMES BROWN, Executor of the will of George Brown, is preparing to file his first and final account and has the following accounts on his books representing the completed transactions of his executorship:

	Dr.	Cr.
\$10,000 P. R. R. 4½s (appraisal)	\$10,500.00	
Income		\$ 450.00
\$10,000 Market St. Ry 4s (appraisal and sale)	10,000.00	10,500.00
Income		200.00
\$5,000 B. & O. 3½s (cost)	4,900.00	
Income	15.00	87.50
Co-partnership of Brown & Davis (proceeds)		30,000.00
Interest on bank balances		250.00
Furniture (appraisal and sale)	800.00	1,000.00
Horses, carriages, etc. (appraisal and sale)	1,600.00	1,500.00
Decedent's debts, funeral expenses, etc	3,500.00	
Safe deposit box rent	10.00	
Executor's commissions at 3% on principal and 5% on income	1,656.63	
Counsel fee and court costs	528.50	
Estate of George Brown, deceased, (appraisal)		22,900.00
James Brown, account distribution	3,000.00	
George Brown, Jr., account distribution	3,000.00	
John Brown, account distribution	3,000.00	
	\$42,510.13	
Cash	24,377.37	
	\$66,887.50	\$66,887.50

Outline the account in the form required by the Orphan's Court. The heirs are James Brown, George Brown, Jr., and John Brown, to whom, under the will, the executor is directed to distribute the entire estate in equal shares.

Answer.

The following forms are made in accordance with the requirements of the Pennsylvania Orphan's Court, known in some states as Surrogate Court and in others as Probate Court. This court has entire charge of the settlement and distribution of estates of deceased persons and of properties held in trust for minors and others incompetent to act for themselves. It will be noted that the question consists of a trial balance taken from an executor's books and from which the accountant is required to make adjustments. It might be advisable to arrange these accounts in regular ledger form, before making the adjusting entries, since by so doing the student can get a clearer insight into the analysis of each account. The executor's appraisement of the estate at the time of filing his inventory showed a valuation of \$22,900.00, but it will be noted that this did not contain the decedent's interest of \$30,000.00 in the partnership of Brown & Davis which was afterward shown by the sale of said partnership interest. This

and the profit on the sale of furniture and Market Street Railway bonds bring the valuation of the estate up to $53,600.00, on which the executor receives his commission of 3%. These details are set forth in the Account of Principal shown in the accompanying statement. The analysis of cash account shows that there was no cash on hand at the beginning, and that the investment in B. & O. bonds was made by the executor and therefore did not affect the principal account. The student will find it to his advantage in solving the question to make a careful analysis of the cash receipts and payments. The amount of commission chargeable to principal and to income can be obtained after determining the corpus of the estate.

Principal Account.

In the Orphan's Court of the City and County of Philadelphia—First and Final Account of James Brown, Executor of the Will of George Brown.

Dr.

The accountant charges himself with principal received as follows:

Inventory and Appraisement—	
$10,000 P. R. R. 4½% bonds	$10,500.00
$10,000 Market Street Railway 4% bonds	10,000.00
Furniture on hand	800.00
Horses, carriages, etc	1,600.00
Total Appraisement	$22,900.00
Additional Debits—	
Proceeds of co-partnership sale	30,000.00
Profit on sales as follows:	
Sale of furniture	200.00
Sale of Market Street Railway 4s	500.00
Total	$53,600.00

Cr.

The accountant claims credit for disbursements of principal as follows:

Decedent's debts, funeral expenses, etc		$ 3,500.00
Counsel fees and court costs		528.50
Loss on sale of horses, carriages, etc		100.00
Commission of 3% on $53,600.00		1,608.00
Balance of principal for distribution		47,863.50
Total Credit		$53,600.00
Advances to legatees:		
James Brown	$3,000.00	
George Brown, Jr	3,000.00	
John Brown	3,000.00	$ 9,000.00
Balance for further distribution		38,863.50
		$47,863.50

Income Account.

Dr.

The accountant charges himself with income as follows:

Interest on P. R. R. bonds	$ 450.00
Interest on Market Street Railway bonds	200.00
Interest on B. & O. bonds (net)	72.50
Interest on bank balances	250.00
Total Income	$ 972.50

Cr.

The accountant claims credit for disbursement of income as follows:

Rent safe deposit vault	$ 10.00
Commission of 5% on $972.50	48.63
Balance of income for distribution	913.87
Total Credit	$ 972.50

Recapitulation.

Balance from Principal Account	$47,863.50
Balance from Income Account	913.87
Total	$48,777.37
Composed as follows:	
Cash on hand	$24,377.37
$10,000 P. R. R. bonds	10,500.00
$5,000 B. & O. bonds	4,900.00
Amount on hand	$39,777.37
Advance to legatees	9,000.00

Distribution to Legatees.

Balance of Estate	$48,777.37
Share of Estate, ⅓ to each	16,259.12

Apportioned as follows—

Legatee	Estate. Share of	Taken. Advances	Due. Balance
James Brown	$16,259.12	$3,000.00	$13,259.12
George Brown, Jr.	16,259.12	3,000.00	13,259.12
John Brown	16,259.13	3,000.00	13,259.13
	$48,777.37	$9,000.00	$39,777.37

The above amounts, aggregating $39,777.37, remain subject to the adjudication of the court, and the executor will distribute the remaining portion as ordered. It will be noted that part of the assets are still in the form of bonds, which will have to be taken by one or more of the legatees instead of cash, otherwise it will be necessary to convert them into cash.

Comments.

The duties of an executor are to take charge of the estate of a deceased person and to carry out the requirements of the testator as set forth in his last will and testament. Since the law is very strict in the matter of handling trust estates every step must be made in accordance with state laws and with the approval of the Probate Court. There is nothing very difficult or unusual in the matter of bookkeeping for an executor, yet it is not in his power to follow his own dictates, since there are carefully defined rules set forth which he must follow. This has reference especially to the manner in which he should state his account to the court, though there is nothing to prevent him from keeping the book accounts according to his own ideas, so long as he is enabled from them to produce all of the information required by the court. The simplest form possible is usually the best, and the courts in any case will frown upon complicated statements which contain many parts or divisions. While any correct form of account keeping will suffice, yet it is advisable to make use of complete double entry in order that all debits and credits may be shown clearly. The books required are Journal, Cash Book, Check Book and Ledger. Other books may be used if circumstances seem to justify them, but in any case the accounts should contain full and complete details so that full information regarding any point or account may be given without delay. If it is desired to keep principal and income separate a cash book should be provided with double columns on each side. The receipts and payments could be entered according to date and placed in their respective columns. In this way the balance of cash on hand belonging to the estate and to undistributed income may easily be ascertained.

It may be stated that the executor is a person named by the testator in his will, while an administrator is one appointed by the court to act in settling the estate in case the person died intestate, that is, without making a will. In case a will has been made but no executor appointed then the court makes the appointment and the person appointed is said to be an "administrator with will annexed." In Pennsylvania the preliminaries in the matter of trust estates are attended to by the Register of Wills, but in making a study of the subject the reader is advised to determine the practice followed in his own state. The form of account presented to the court differs in the various states but is usually reduced to the two sides known as debits and credits, that is, the executor or accountant charges himself with all properties coming into his possession and with all moneys or properties leaving his possession. The balance represents the capital or balance of the estate. All income and expenditure other than that pertaining to the estate must be shown in a separate account of debits and credits as indicated in the accompanying Income Account. It is very important that principal and income be kept separate, though in many cases it is very hard to distinguish between them. The principal is known as the capital or corpus of the estate or trust and is the actual property in which the estate may be invested at the time. This is usually appraised by independent appraisers; to this will be added profits on the sale of any property held as belonging to principal, and any other assets of the estate which subsequently come into the possession of the executor.

Credits or deductions from principal include losses from the sale of property belonging to principal, funeral expenses, legal and state charges, liabilities of the testator, commissions to the executor, etç. Income consists of the proceeds of what the property produces; the receipts of profits which come from its use in business accruing within a given time. In other words, the profits which would accrue in connection with an ordinary commercial business may, in most cases, be safely considered in connection with a trust. The charges against income usually consist of expenses of management, trustee's commission on income, ordinary taxes, water rates, repairs, insurance, interest on incumbrances, general expenses, etc. In the apportionment of principal and income if no agreement can be reached as to their application, a decision of the court will have to be obtained. All transactions affecting real estate are required to be shown separately.

Following is the form of account required by the Surrogate Court of New York State:

SURROGATE COURT,
County of New York,

In the Matter of
The Judicial Settlement of the account of
1. ....
Executor of the Last Will and Testament of
....
Deceased.

ACCOUNT
OF
PROCEEDINGS.

2. To the Surrogate of the County of New York:

I, ..., of the City, County and State of New York, do render the following account of my proceedings as executor of the last Will and Testament of................................, late of the City of New York, deceased.

3. On the.................... day of...................., 19..., Letters Testamentary were issued to me.

4. On the.................... day of...................., 19..., I caused an Inventory of the personal estate, therein set forth amounts, by appraisement by the Appraisers duly appointed, to $....................

5. Schedule A, hereto annexed, contains a statement of all the property mentioned in said Inventory, sold or collected by me, with the prices realized, showing the increase on the appraised value, such increase amounting to $..................

6. Schedule B, hereto annexed, contains a statement of all amounts realized from personal property, sold or collected by me, not mentioned in the said Inventory, but for which I am legally accountable, amounting to $....................

7. Schedule C, hereto annexed, contains a statement of all amounts received by me for interest and dividends on securities, rents, and from other sources of income accruing subsequent to the death of the said deceased, amounting to $.................

No other assets than those in said Inventory, or herein set forth have come to my possession or knowledge and all the increase in the value of

any asset of said deceased is allowed or charged in the said schedules above mentioned.

8. Schedule D, hereto annexed, contains a statement of all the property mentioned in said Inventory, sold or collected by me, with the prices realized, showing the decrease on the appraised value, such decrease amounting to $.................

9. Schedule E, hereto annexed, contains a statement of all moneys paid by me for funeral charges and testamentary expenses, amounting to $.................

10. On or about the....................day of...................., in the year 19..., I caused a notice for claimants to present their claims against the said estate to me within the period fixed by law, and at a certain place therein specified, to be published in two newspapers, according to law, for six months, pursuant to an order of the Surrogate of the County of New York to which order, a notice for claimants to present their claims against the said estate to my account.

11. Schedule F, hereto annexed, contains a statement of all amounts paid by me in settlement of sundry debts and claims against the said estate, with the names of all creditors, and the time of such payment, amounting to $.................

12. No other debts or claims than those mentioned in Schedule F have come to my knowledge.

13. Schedule G, hereto annexed, contains a statement of all moneys paid by me to.................................., widow of the deceased.

14. Schedule H, hereto annexed, contains a statement of all moneys paid by me for necessary expenses incurred in the management of said estate, amounting to $.................

15. Schedule J, hereto annexed, contains a statement of all items of personal property mentioned in said inventory, remaining unsold or uncollected, and their appraised value, amounting to $.................

16. Schedule K, hereto annexed, contains the names of all persons who are in any way interested in the estate of the deceased, how interested, and their respective places of residence, to the best of my knowledge, information and belief.

17. Schedule L, hereto annexed, contains a statement of all other facts affecting my administration of said estate, my rights, and those of others interested therein.

The following is a summary of my account:

Summary.

18. I charge myself—

With Amount of Inventory.............................$

With Amount of Increase, as per Schedule A..............

With Amount realized from assets not mentioned in Inventory, as per Schedule B.............................

With amount received as Income, as per Schedule C........

Total Charges ....$

I credit myself—
With Amount of Decrease, as per Schedule D.............$
With Amount paid for Funeral Expenses, as per Schedule E
With Amount paid in settlement of sundry Debts and Claims, as per Schedule F.................................
With Amount paid to widow of deceased, as per Schedule G.
With Amount paid for Necessary Expenses of Administration, as per Schedule H..............................
With Amount of Sundry Items mentioned in Inventory, remaining unsold or uncollected, as per Schedule J......

Total Credits ....$
Leaving a balance of...........................$

19. Consisting of cash to be distributed to those entitled thereto, subject to the deduction of the amount of my commissions and the expenses of this accounting.

20. The said Schedules which are severally signed by me are part of this account.

All of which is respectfully submitted,

....
Dated, New York. Executor.

MINING ACCOUNTS.

Pa 1911

Problem No. 1.

THE FOLLOWING is the trial balance of the X. Y. Z. Coal Mining Company, as of December 31, 1912:

	Dr.	Cr.
Cash	$ 5,674.50	
Breaker and machinery	145,000.00	
Office building	5,000.00	
Blacksmith shop	4,000.00	
Inside construction	15,675.00	
Car and mine rail account	7,534,50	
Horses and mules	5,600.00	
Accounts receivable	35,112.25	
Bills receivable	10,000.00	
Capital stock—Common		$ 50,000.00
Capital stock—Preferred		100,000.00
Coal sales		257,890.00
Accounts payable		12,500.00
Surplus		17,709.35
Depreciation on buildings & machinery		12,000.00
Supplies	8,240.00	
Pay-roll—outside	24,701.50	
Pay-roll—inside	110,434.25	
Salaries—superintendent, etc.	6,000.00	
Salaries—office clerks	4,500.00	
Office expense	1,147.35	

General expense	750.00	
Claims for injuries	4,000.00	
Insurance (expires July 1, 1913)	5,500.00	
Repairs to buildings	4,075.00	
Repairs to construction	3,445.00	
Barn expense	1,500.00	
Selling expense	4,500.00	
Royalty account	30,500.00	
Water	800.00	
Fuel	935.00	
Timber and props	5,475.00	
	$450,099.35	$450,099.35

The total output for the year was 132,300 tons.

An examination of the books and accounts shows that the following charges had not been entered: Horses and mules, $2,200; car and mine rail account, $1,450; claims for injuries, $1,000. During the year the bookkeeper, through error, charged to inside construction $3,415, instead of to inside pay roll.

The coal is mined on lease that averages 20 cents per ton. The inventory is as follows: Timber and props, $1,500; powder, $555; oil, etc., $175. In preparing the above statements allowance for depreciation on buildings and machinery may be considered at the rate of 5 per cent.

Prepare income and profit and loss account and balance sheet, as of the above date, showing gross earnings and net earnings, also the average cost per ton.

Income and Operating Account—Year Ended Dec. 31, 1912.

Income.

Sales of Coal			$257,890.00

Operating Expenses.

Inside costs:			
Supplies	$ 8,240.00		
Less inventory	730.00		
		$ 7,510.00	
Pay roll, inside		113,849.25	
Salaries, say 60% of $6,000		3,600.00	
Repairs to construction		3,445.00	
Barn expenses		1,500.00	
Royalties paid	$30,500.00		
Less prepayment	4,040.00		
		26,460.00	
Water		800.00	
Fuel		935.00	
Timber and props		3,975.00	
Depreciation of construction, cars, rails		1,062.23	
Total inside costs		$163,136.48	

Outside costs:		
Pay roll on outside	$ 24,701.50	
Salaries, say 40% of $6,000	2,400.00	
Repairs to buildings	4,075.00	
Depreciation of buildings	7,450.00	
Total outside expenses	$ 38,626.50	
Total operating costs	201,762.98	
Add selling expenses	4,500.00	
Cost of coal sales		$206,262.98
Gross earnings of mine		$ 51,627.02

Profit and Loss Account—Year Ended Dec. 31, 1912. omit

~~Credits.~~

Gross earnings from operating account		$ 51,627.02

omit

~~Debits.~~

Clerks' salaries	$4,500.00	
Office expenses	1,147.35	
General expenses	750.00	
Claims for injuries	5,000.00	
Insurance used	2,750.00	
Depreciation of office building	250.00	
Total general expenses		$ 14,397.35
Net earnings of company		$ 37,229.67

Cost Summary.

(Per ton of coal.)

Coal output for year 132,300 tons.

Inside operating costs	$163,136.48	$1.233	per ton
Outside operating costs	38,626.50	.292	" "
Total operating costs	$201,762.98	$1.525	" "
Selling costs	4,500.00	.034	" "
General charges	14,397.35	.108	" "
Aggregate cost	$220,660.33	$1.667	" "

Net earnings, 28c per ton.

Balance Sheet, Dec. 31, 1912.

Assets.

Cash on hand	$ 5,674.50
Bills receivable	10,000.00
Accounts receivable	35,112.25
Insurance unexpired	2,750.00

Royalties prepaid	4,040.00
Powder on hand	555.00
Oil on hand	175.00
Inside construction	12,260.00
Car and mine rail account	8,984.50
Horses and mules	7,800.00
Timber and props	1,500.00
Blacksmith shop	4,000.00
Breaker and machinery	145,000.00
Office building	5,000.00
Total assets	$242,851.25

Liabilities.

Accounts payable	$ 17,150.00
Reserve for depreciation	20,762.23
Surplus, Dec. 31, 1911	17,709.35
Net earnings for year	37,229.67
Capital Stock—Common	50,000.00
Capital stock—Preferred	100,000.00
	$242,851.25

Comments.

Mine accounting may be likened unto that of a manufacturer; the mine operations in digging, hoisting and preparing the coal for shipment are analogous to the process of manufacturing articles for sale to the trade. Once produced and ready for shipment, the business of sale and delivery in each case resolves itself into a matter of salesmanship, as in any trading concern. The mining company either owns the mines or leases them for a term of years on a royalty basis of so much per ton of coal mined. The company which operates its own mines may open an account for each mine, as in the case of branch office accounting, to which shall be charged all outlay for development, necessary construction improvements, operating charges, expenses, etc. Income from sales, less all operating and general charges shows the net earnings of the mine for any fiscal period. In case the mine is leased to another company, the bookkeeping would be reduced to the entry of royalties received and of depreciations and other expenses incurred. Since the head office is usually located in some city, it will be seen that operations of the mine must be kept track of at the colliery and then sent to the head office in the form of detailed reports. From these reports entries are made in the proper accounts. The reports are carefully prepared by the superintendent, or by his clerks, and contain full details pertaining to operations, coal mined, broken, stocked and shipped, labor charges, pay roll, accidents, etc. The miner is paid either by the ton or carload of coal mined, but deductions are made for helpers (if any), supplies furnished (as powder and tools), rent of house, store charges, and probably for benefit or relief fund. The balance due is paid by the manager in cash or by check sent from the home office. It will be seen that care must be exercised in keeping track of supplies, stores,

etc., charged to each miner's account, and that this must be carefully reported to the home office. Sales are usually made at the head office, though shipments are sent direct from the mine, according to directions supplied.

From this brief explanation it will be seen that very little accounting is done at the mines and that entries in the home office books are made from the various mine reports sent in by the manager or superintendent. From the information thus received detailed monthly reports of operations, labor costs, output, etc., are carefully compiled. Monthly statements of income and operations are usually prepared also for the benefit of the management.

The question under review presents another feature of mine operations, for in this case the operating company leases the mine on a royalty basis, according to the output of coal. The accounts will differ slightly from those of a company owning the mine, but in other respects records of operations are kept in a similar manner. The royalty payments are considered part of the cost of operation in much the same respect that the depreciation is part of the operating cost for the company owning the mine. In consequence, the mooted question of mine depreciation need not be discussed in this article; however, the various properties belonging to this operating company must necessarily be considered as having depreciated. It will be noted that the depreciation is mentioned in connection only with building and machinery, but here it is considered on all properties shown in the problem. The division of depreciation among the inside costs, outside costs, and profit and loss account are simply according to the writer's ideas, though it is true that they are not called for in the question. The forms of statements used are not given as model forms for mining corporations, but simply as one of many plans that might be shown. It is true also that some of the items chargeable to the three divisions might be differently arranged, but this, in the end, would not affect the genuineness of the solution.

Mines are usually leased for a definite number of years, therefore all costs of construction and buildings should be written off over the life of the lease. Since 5 per cent depreciation is mentioned in the question, it is assumed, for working purposes, that the lease had a currency of twenty years. The manner of conducting operations is similar to those described above and, of course, the various reports to the home office are prerequisites. Space will not permit of giving further attention to the forms used, but anyone familiar with mine operations and accounting forms could without much difficulty design suitable blanks for this purpose. It might be said that the accounts used in this question are very few compared with those used by some of the larger mining companies. Where a carefully compared system prevails numerous accounts are kept for the various classes of charges, expenses, day and contract labor, supplies, income, and administrative expenses. Not being familiar with the mining laws of New York State, where this problem was given, we are refraining from making comments on statutory requirements. It might be noted in connection with the statement presented herewith that inside costs refer to expenses within the mine, while outside costs refer to charges

incurred after the coal is brought to the surface. Insurance account is assumed to have been for one year and that one-half of it is unexpired. This is merely an assumption, and it might be even better to consider ⅓ unused. Royalties to the extent of $4,040 have been prepaid, as will be seen by a comparison of the royalty account with the tons of the output. Interesting statistical features are shown in the cost summary on the basis of one ton of coal. We must presume that the entire output of coal has been disposed of, since no mention of coal in stock has been made. Claims for injuries might have been considered as an operating charge; however, it is here considered otherwise; an insurance might have been so considered also, at least in part. The adjusting entries called for should be made before the statements are completed.

Adjusting Entries.

1.	Pay roll inside	$3,415.00	
	To Construction		$3,415.00
2.	Car and mine rail account	1,450.00	
	To Accounts payable		1,450.00
3.	Horses and mules	2,200.00	
	To Accounts payable		2,200.00
4.	Claims for injuries	1,000.00	
	To Accounts payable		1,000.00

Problem No. 2.

THE following question, which appeared in a Pennsylvania examination, is selected as one which was no doubt designed by the examiners to test the thinking powers of the candidate, rather than one to test his ability as a mathematician. The few amounts given are to be used as a basis in designing the accounts called for, but the answer is purposely presented in a more exhaustive plan than the question really requires.

Question.

A coal mining company, "A," desires to acquire another smaller mining corporation, "B," the capital stock of which is $100,000. It purchases the entire capital stock for $300,000, and in order to obtain funds, borrows that amount, giving five notes, due in one, two, three, four and five years, for $60,000 each, and bearing interest at the rate of 6 per cent per annum.

Company "B" owns no real estate, but operates under a lease which will expire fifteen years after the date of the above-mentioned purchase. At the termination of the lease all permanent improvements, buildings, etc., other than moveable equipment, become the property of the lessor.

At the time of the purchase it is found that the current or liquid assets of company "B," other than the investment in buildings and equipment, amount to $50,000. It is also necessary to expend $10,000 per annum for the first two years in the erection of permanent buildings, in addition to the ordinary charges for maintenance.

It is required that the stock of company "B" shall be worth par at the termination of the lease. It is further desired that interest on the notes given by "A" should be extinguished by the income received from "B," and also that the investment of "A," except as represented by the par value of the stock of company "B," should be extinguished before the termination of the lease.

Both companies are to be operated entirely independently of each other, and the only connection is through that of stock ownership.

The reply to this question should be in the nature of a clear and concise plan, stating how these transactions should be treated on the books of both companies. Include with this a set of ledger accounts, illustrating the workings of the plan you would recommend.

Answer.

Before submitting an answer, the problem should be studied from all viewpoints in order that its meaning and requirements may be clearly conceived, and it is strongly recommended that anyone interested, work it up before consulting this answer. A summary of the main points of the question may be made if desired, about as follows:

Two companies, fully established, operating independently.

"A" company paid $300,000 for the shares of "B" company of $100,000.

This is at a premium of $200,000, which amount is to be spread over fifteen years, $13,333.33 each year.

"A" borrows $300,000 on notes to pay for "B" stock.

Notes to be paid within five years, out of own funds.

Net income of "B" goes to "A" in dividends.

Amount paid by "A" for premium on stock to be charged against dividends received of "B."

Interest on notes charged to same account.

"B" company stock must be worth par in 15 years.

It must have $100,000 in cash or its equivalent at that time.

$300,000 paid by "A" goes to stockholders of "B," who relinquish all stock.

In 15 years "B" either re-leases, secures other property, or dissolves.

"B" has $50,000 current assets, and $50,000 evidently charged to improvements, to offset capital of $100,000.

During the next two years spends $20,000 on improvements.

Now has $70,000 of permanent improvements to wipe out over remaining years.

"B" must make enough to pay expenses, extinguish improvements of $70,000, and pay dividends to "A."

"A" must get at least enough to extinguish premium of $200,000 on stock, and pay interest on notes, $54,000=$254,000.

Allow, say, $10,000 per year extra for profits.

Show accounts affected on books of "A" and "B."

Income from Company B.

Year	Interest on Notes	Extinguishment of Premium	For 10% Net Dividend	Total Income
1908	$18,000.00	$13,333.33	$10,000.00	$41,333.33
1909	14,400.00	13,333.33	10,000.00	37,733.33
1910	10,800.00	13,333.34	10,000.00	34,133.34
1911	7,200.00	13,333.33	10,000.00	30,533.33
1912	3,600.00	13,333.33	10,000.00	26,933.33
1913	....	13,333.34	10,000.00	23,333.34
1914–22	....	120,000.00	90,000.00	210,000.00
Total	$54,000.00	$200,000.00	$150,000.00	$404,000.00

Company "A's" Records.

We are not given any details as to the accounts and capital stock of "A," and are therefore, interested only in the operations and income from "B" and investment therein. All else is excluded from consideration. For the purpose of completing exhibits, we shall provide for an income or dividend from "B" sufficient to net a dividend of 10 per cent after allowing for loan interest and a portion of extinguishment of investment premium. Loan payments, of course, are made during the first five years, but not out of income, and therefore not necessary to the exhibit.

It will be seen from this exhibit that "A's" investment in "B" stock is now reduced to par, $100,000.00, and that the investment has netted a 10 per cent dividend during the 15 years of lease operations. The total dividends paid by "B" amount to $404,000.00. The lease has expired and must either be renewed or some other use found for this capital—in case the company does not go into liquidation.

Company "B's" Records.

When "B" company's stock was purchased by "A" company, "B" had current assets amounting to $50,000.00, and since the capital stock is $100,000.00 some other asset or charge must be included to offset the debit. Then we have the following statement:

B Company Balance Sheet on Amalgamation.

Current Assets	$ 50,000.00	Capital Stock	$100,000.00
Buildings and Improvements.	50,000.00		
	$100,000 00		$100,000.00

Other items may be included in the books at this time, if desired, but consideration of them has nothing to do with the principles involved or with the requirements of the examining board.

In addition to the buildings shown above, "B" company pays out $20,000 for improvements, making in all $70,000 which must be written off during the fifteen years. Then according to the dividends allowed on stock, it is necessary to pay operating expenses and charge off a portion of the

improvements each year before paying the dividend. It will be seen from this that during the fifteen years under consideration "B" company must earn enough to pay running expenses and write of $70,000.00 of improvements in addition to the net profit of $404,000.00 paid over to "A" company in the form of dividends. Assuming the royalties and expenses to have been $10,000.00 per annum, we have the following:

Company B Account.

Earnings and Expenses for 15 Years.

For dividends to Company "A"	$404,000.00	
For permanent improvements	20,000.00	
For extinguishment fund	50,000.00	
For operating expenses	150,000.00	
Total earnings		$624,000.00
Deduct		
Operating expenses	$150,000.00	
Permanent improvements	20,000.00	
Extinguishment fund to increase capital to par	50,000.00	
Total outlay for operations		220,000.00
Balance, net profit, dividends paid to "A" Company.		$404,000.00

The above exhibit shows all the income and expenses for the entire period under review, but it would be just as satisfactory to have omitted the consideration of any items outside of those necessary for profits to "A" and for replacement of $70,000.00 expended on improvements. Writing off permanent improvements, the $50,000.00 standing to buildings, etc., at the time of sale must be written off during the fifteen years, also the $10,000.00 expended during each of the first two years. How shall it be done? The following three plans are suggested:

(1) Write off by a charge against profit and loss an amount each year in proportion to the number of years over which it shall run. For example, at the end of the first year $60,000.00 will be the amount charged to buildings, etc.; one-fifteenth of this, or $4,000.00 deducted, leaves a balance of $56,000.00. At the end of the second year this will be increased to $66,000.00, which amount shall then be spread over the remaining fourteen years, $4,714.29.

(2) Charge off one-fifteenth of the entire $70,000.00 each year, $4,666.67. This amount may be credited either to reserve or extinguishment of improvements, or to the improvements account itself.

(3) Depreciate the amount standing each year in proportion to the number of years, as one-fifteenth of $50,000.00, etc., as follows:

First year, total	$50,000.00
Less 1/15 depreciation	3,333.33
	$46,666.67
Add expenditure	10,000.00
Second year, balance	$56,666.67
Less 1/14 depreciation	4,047.62
	$52,619.05
Add expenditure	10,000.00
Third year, balance	$62,619.05
Less 1/13 for depreciation	4,816.85
Balance	$57,802.20

This is the plan followed in setting up the accounts, shown in the accompanying exhibits.

LEDGER, COMPANY A—(Using only accounts affected).

Investment Company B Stock.

Cash at commencement	$300,000.00	Written off to profit and loss during 15 years	$200,000.00
		Balance	100,000.00
	$300,000.00		$300,000.00
Balance	$100,000.00		

Notes Payable.

Year 1 Cash	$ 60,000.00	Cash, at time of issue	$300,000.00
" 2 "	60,000.00		
" 3 "	60,000.00		
" 4 "	60,000.00		
" 5 "	60,000.00		
	$300,000.00		$300,000.00

Income from Investment.

Profit and loss	$404,000.00	Dividends	$404,000.00

Interest on Notes.

Cash for five years	$ 54,000.00	Profit and loss	$ 54,000.00

Profit and Loss Account.

For 15 years:—			
Interest	$ 54,000.00	Income from Investments	$404,000.00
Extinguishment	200,000.00		
Net profits in dividends	150,000.00		
	$404,000.00		$404,000.00

Dividend Account.

Cash paid during period	$150,000.00	Profit and loss	$150,000.00

Cash Account.

Sale of notes	$ 300,000.00	Investment B stock	$ 300,000.00
Dividends from Co. B	404,000.00	Interest on notes	54,000.00
Other sources, and used for note payments	300,000.00	Redemption of notes	300,000.00
		Dividends paid	150,000.00
		Balance	200,000.00
	$1,004,000.00		$1,004,000.00
Balance	$ 200,000.00		

Note.—This cash balance is the fund reserved for extinguishment of premium on investment. We may change the above figures for receipts from other sources if desired, from $300,000.00 to $100,000.00, and use this extinguishment fund to apply on payment of notes.

LEDGER, COMPANY B—(Using only accounts affected).

Capital Stock.

		Paid up	$100,000.00

Buildings and Improvements.

Balance at beginning	$ 50,000.00	Profit and loss as per detail	$ 70,000.00
Cash since beginning	20,000.00		
	$ 70,000.00		$ 70,000.00

Current Assets (Cash, etc.)

Balance at beginning	$ 50,000.00	Operating expenses	$150,000.00
Earnings	624,000.00	Dividends	404,000.00
		Improvements	20,000.00
		Balance	100,000.00
	$674,000.00		$674,000.00
Balance	$100,000.00		

Profit and Loss.

Operating expenses	$150,000.00	Earnings, per detail	$624,000.00
Extinguishments of bldgs., etc.	70,000.00		
Dividends	404,000.00		
	$624,000.00		$624,000.00

Dividend Account.

Cash paid	$404,000.00	Profit and loss	$404,000.00

Balance Sheet, Company B.

Current assets	$100,000.00	Capital stock	$100,000.00

FIRE INSURANCE ACCOUNTING.

Problem No. 1.

THE FOLLOWING question is taken from a Pennsylvania Examination and is used as a basis for study in the accounts of a fire insurance company. From the trial balance,—

(a) Prepare a balance sheet at December 31 and the relative income account for the year ending that date.

(b) Describe what procedure you would adopt in verifying the assets and liabilities. Make any criticisms in respect of reserves apparently omitted.

Trial Balance, December 31.

Stocks and bonds (book value)	$3,000,000.00	
Mortgage loans	1,000,000.00	
Interest receivable on mortgage loans	1,000.00	
Real estate	500,000.00	
Cash at banks and on hand	300,000.00	
Uncollected premiums	500,000.00	
Capital stock		$ 500,000.00
Unpaid dividends		100,000.00
Surplus account, January 1		2,000,000.00
Gross premiums		3,000,000.00
Return premiums	5,500.00	
Income from stocks and bonds		25,000.00
Interest on mortgage loans		10,000.00
Rents received		200.00
Losses	210,000.00	
Reinsurance premiums	10,000.00	
Commissions	5,000.00	
Taxes	4,000.00	
Salaries	40,000.00	
Uncollectable premiums	3,000.00	
Rebates	200.00	
Real estate expenses	5,000.00	
Real estate losses	3,000.00	
Postage	500.00	
Legal expenses	500.00	
Maps	15,000.00	
Underwriters' boards and tariff associations	30,000.00	
Inspections and surveys	2,000.00	
General expenses	500.00	
	$5,635,200.00	$5,635,200.00

Comments.

The business of a fire insurance company is to sell protection against loss by fire, in return for which it receives compensation in the form of premiums. The amount of income received from premiums depends upon the volume of business done (insurance placed), and also upon the length

of time for which the risk has been undertaken, as for one month, one year, two or five years, or perpetual. The "premium" is the compensation paid by the insured to the insurer for which he is insured against loss by fire, and the "policy" is the contract or agreement entered into between the contracting parties. The protection sold by the company has to be delivered only in case of fire, and then only to the extent agreed upon.

Fire insurance companies have all risks carefully classified, and the rate of premium charged depends largely upon the classifications. These have reference to location, condition of surrounding buildings or proximity to hazardous risks, construction and use of building, furnishings and goods handled therein, public and private fire protection, etc. The companies have each city carefully surveyed and mapped so that every location and risk is not only clearly set forth in its maps but accurately surveyed, inspected and described from top to bottom, including foundation, roof, surroundings and all moral hazards.

Insurance companies are organized and incorporated very much as other business corporations (under special insurance laws) and their official business is not at all dissimilar except in the matter of making reports. The laws of Pennsylvania (which no doubt are similar to those of other states) require at least ten persons for incorporation with an authorized capital of at least $500,000. At least 50% of the capital stock must be subscribed and at least 10% paid in thereon; the remainder thereof must be paid up within six months. Subscribers to the original capital of a company usually contribute an extra amount for the purpose of creating a surplus. This insures the new company against insolvency and enables it to meet any heavy losses that may occur during its infancy. Each stockholder, for instance, will pay in $150 or $200 for each $100 share of stock taken. After the company is well established any remaining stock is usually sold at an advance over the original price.

An exhaustive annual report and statement is required to be sent to the Insurance Commissioner of every state in which the company does business. The reports must comply with the laws of said states, and where required, a deposit of securities must be made. This report inquires into every detail of the company's business and financial condition and furnishes a most exhaustive exhibit of its affairs. The reports for fire, life and other insurance companies are an interesting study and are recommended to students of accountancy. In reporting assets the company is required to deduct those which are not usually available for settlement of fire losses, as furniture, supplies, printed matter, etc., the company's own stock owned or loans made thereon, bills receivable past due, agents' balances after a brief time has elapsed, loans on personal security, book values of ledger assets over market value, etc. The insurance department is always exacting, and any assets not capable of realizing full value on forced sale are either omitted or reduced to a safe working basis. All liabilities, no matter how small, of a real or contingent nature, must be accounted for, and all fire losses unpaid, whether in dispute or not, must be included at face value of risks.

Premiums and Reserves.

The insurance premium received by the company for fire risks is generally paid in advance instead of at stated periods, as in a life insurance company. This premium covers the full term of the policy, whether it be for one, three or five years, or perpetual, and therefore cannot all be considered as earnings for the current year. That portion which has already been earned, according to months in force, may be considered as earned income for the period, while the remainder must be held as a reserve for possible fire losses during the years which the policy has yet to run. If the policy is for one year only and expires at the end thereof, then the premium received thereon would be considered as entirely earned and included as revenue for the year; but if the policy (beginning on say June 30th of the current year) continues over a term of three years, then one-sixth would belong to earnings of the first year and five-sixths carried as unearned reserve to meet future losses. The unexpired premium in each case is considered in proportion to the currency of the policy either in months or days. The fire losses which occur each year are chargeable against the earnings for that year, and the balance, of course, represents the net earnings of the company as available for distribution in the form of dividends. The reserve requirements are governed by the laws of each state and necessarily vary to some extent. It must be strictly maintained, however, or the Insurance Commissioner will promptly proceed to wind up the affairs of the company. The Pennsylvania laws require that the reserve must be maintained under all circumstances. They further state that the Insurance Commissioner "shall calculate the re-insurance reserve for unexpired fire risks, by taking fifty per centum of the premiums on all unexpired risks that have less than one year to run, and a pro rata on all premiums received on risks that have more than one year to run." In marine insurance, all (100%) of the unearned premiums must be reserved against possible future losses. Reserves for perpetual policies are usually about 90% of the premiums received. It may be said that reserves do not always appear on the books as such, but are carefully set forth only in the official report to the State, a copy of which is usually kept by the company. Unearned premiums are shown in the premium account on the company's ledger and required to be reapportioned at the end of each year. Non-ledger assets are, of course, deducted in the report, though they may continue to be shown on the company's ledger. From this it will be noted that the books and the report to the Insurance Commissioner are not always entirely in harmony with each other. Outstanding insurance policies do not form a part of the ledger accounts, but simply a record in the proper books.

Points on the Problem.

The question lacks many details that would ordinarily be required to enable one to prepare a satisfactory statement, but this no doubt was the intention of the examiners, since the candidate is required to display his knowledge of fire insurance accounting without assistance. The book value of stocks and bonds is given, but we are not told the par or market value thereof. Real estate is evidently to be taken at the book value, though the loss of $3,000 thereon may be considered as depreciation, and

uncollected premiums may be considered as good, since $3,000 has already been written off. We are not able to determine whether or not there is accrued interest on mortgages and bonds, other than the $1,000 shown, and must therefore take the income from these sources as complete to date. Fire losses for the year amount to $210,000. Return premiums and re-insurance premiums must be deducted from gross premiums. Gross premiums include premiums received during the year and all reserves carried over from previous years. It is obvious that only part of this amount can be apportioned as earnings for the current year, while the required reserves must be pro-rated to unexpired risks. This is the crucial test in the problem, and certain conclusions must necessarily be assumed. If the aggregate outstanding insurance was given and classified as to time to run, the pro-rating of reserve premiums would be an easy matter, but since the examiners have purposely omitted this information, we will suppose that $750,000 has been earned during the year and that $2,250,000 is the unearned reserve. From this year's earnings are deducted the fire losses, re-insurance and return premiums. The surplus account is very large when compared with the capital, and no doubt part of it was contributed by the original subscribers. The capital and surplus funds of insurance companies must be invested only in first-class mortgages and gilt-edged securities, on which there is required a given margin of safety. The main books used by fire insurance companies are ledger and cash book, the latter with special columns to suit the income and disbursements. There are numerous records kept on cards and in books of various kinds, also reports from agencies, from whence the majority of the business comes.

INCOME ACCOUNT, December 31.

EXPENSES.		INCOME.	
Commissions	$ 5,000.00	Premiums earned	$734,500.00
Taxes	4,000.00	Income from stocks and bonds	25,000.00
Salaries	40,000.00	Interest on mortgage loans	10,000.00
Uncollected premiums	3,000.00	Rents received	200.00
Rebates	200.00		
Real estate expenses	5,000,00		
Real estate loans	3,000.00		
Postage	500.00		
Legal expenses	500.00		
Maps	15,000.00		
Boards and associations	30,000.00		
Inspections and surveys	2,000.00		
General expenses	500.00		
Total expenses	$108,700.00		
Balance down, excess of income over expenses	661,000.00		
	$769,700.00		$769,700.00
Fire losses paid during year	$210,000.00	Balance, down	$661,000.00
Net earnings for year	451,000.00		
	$661,000.00		$661,000.00

Note.—The Income and Disbursements statement submitted to the insurance commissioner is always carefully analyzed and differently arranged from the above on regularly printed forms. The same is true of the Assets and Liabilities.

Balance Sheet, December 31.

ASSETS.		LIABILITIES.	
Stocks and bonds	$3,000,000.00	Unpaid dividends	$ 100,000.00
Mortgage loans	1,000,000.00	Premiums unearned, not reserve	2,250,000.00
Real estate	500,000.00		
Cash	300,000.00		
Uncollected premiums	500,000.00	Total liabilities	$2,350,000.00
Interest accrued on mortgage loans	1,000.00	Capital stock	500,000.00
		Surplus Jan. 1	2,000,000.00
		Net earnings for year	451,000.00
	$5,301,000.00		$5,301,000.00

PREMIUM ACCOUNT.

Gross premiums received		$3,000,000.00
Less reserve for re-insurance, estimated		2,250,000.00
Balance available as income for year		$ 750,000.00
Deduct:—		
Return premiums	$ 5,500.00	
Re-insurance premiums	10,000.00	15,500.00
Balance, premiums earned		$ 734,500.00

Problem No. 2.

THE Ganver Garment Company, who were burned out in the night of September 16th, filed with the insurance companies a claim for $95,436.70, which you are called in to verify or disprove.

You find the following Balance Sheet as of Aug. 1st, 1912:

ASSETS.		LIABILITIES.	
Cash	$ 9,224.67	Accounts payable	$ 59,611.46
Accounts receivable	88,669.43	Bills payable	42,183.24
Bills receivable	2,473.62	Capital stock	50,000.00
Merchandise inventory	42,618.97	Surplus	14,203.16
Machinery	20,419.04		
Furniture and fixtures	2,000.00		
Prepaid taxes and insurance	592.13		
Total	$165,997.86	Total	$165,997.86

At the close of business September 16th, their ledger showed the following balances:

	Dr.	Cr.
Capital Stock		$ 50,000.00
Surplus		14,203.16
Cash	$ 5,418.22	
Accounts receivable	118,871.14	
Bills receivable	6,217.24	
Accounts payable		72,898.66
Bills payable		63,114.02
Machinery	21,619.34	
Furniture and fixtures	2,147.30	
Inventory, August 1, 1912	42,618.97	
Dividends	6,000.00	
Sales		162,917.31
Merchandise purchases	103,430.22	

Labor	37,619.14	
Power, light and heat	3,716.47	
Factory expense	7,119.11	
Office salaries	2,250.00	
Office expenses	319.54	
Selling expenses	4,716.92	
Insurance	318.16	
Taxes	751.38	
Totals	$363,133.15	$363,133.15

The Company's Gross Profits on Sales has been very uniform, averaging 20 per cent ever since the business was started. Ten per cent for depreciation has been written off every year from machinery and furniture and fixtures.

Insurance policies covering merchandise, machinery and furniture and fixtures aggregate $100,000, and all contain the 80% co-insurance clause.

The merchandise and furniture and fixtures were a total loss. The salvage in machinery is valued at $2,500, at which value the insured decided to retain it.

Prepare statement of claims against the insurance companies:

Answers and Comments.

The question asks only for a statement of claim against the insurance companies, which necessitates the determining of values at the time of the fire. To do this requires an analysis of the figures presented and the establishment of an equitable valuation of the properties destroyed. In a manufacturing business, such as the one under consideration, it is apparent that the direct manufacturing charges form a part of the cost of goods destroyed and should be included. This is particularly the case with goods in the process of manufacture. The direct costs shown in the question, however, are applicable to goods that have been completed and sold, as well as to those still in process; therefore we must consider them in the aggregate instead of separately. In the manufacturing costs we have included labor, power, light and heat and factory expenses, as will be seen by an inspection of the accompanying statement. It would be proper, no doubt, to add a portion of the insurance and taxes also if we knew what portion was applicable to the month and a half of operations. Depreciation of machinery for one and one-half months would be a proper charge if considered. It is included, however, in the inventory valuation itself, since it seems inadvisable to write off further depreciation. The fact that 10% has been written off annually does not mean that the book figures present a true valuation. It may even be worth considerably in excess of the amount shown. The inventory of furniture and fixtures is admitted at book value, though it would be wise and prudent to write it down. In an extraordinary case such as this it would seem advisable to include in the cost of manufactured goods a portion of the general and administrative expenses. No doubt a portion at least would be directly applicable thereto in the same manner as labor and direct factory expenses. The matter

of doubt in the consideration of a case like this suggests to the accountant the desirability of a conservative decision in making up the claim for goods destroyed. It might even be claimed by the manufacturer that the goods were worth more than the bare manufacturing cost on the assumption that if purchased elsewhere a higher price would have to be paid. It is evident that the company's claim for $95,436.70 contains either estimated profits or considerably more loading than we have admitted, since it seems impossible to reconcile it with the information submitted. No doubt the accountant after investigation determined that the gross profit for the past years averaged 20 per cent, while the company's officials were estimating differently. The gross profit on sales would have to be estimated at about 35% to result in a claim such as the one presented by the company. We take the 20% gross profit on the cost of sales and not on the selling price, as is so frequently done in trading concerns. Where costs are well established, as in a manufacturing business, percentages should be based on the cost price instead of on the sales. In arranging the gross profit, however, considerable care should be exercised to see that the elements of cost are maintained uniformly from year to year.

The adjusters of fire losses are usually shrewd, capable men, and while they are disposed to guard the interests of the insurance companies, they are also desirous of making equitable adjustments of damage claims. Insurance companies desire to continue doing business, and it is apparent that if fair dealing in settling claims of patrons is not maintained, they will look elsewhere for protection. And yet they can not be expected to accept under all conditions the claims presented for fire losses. The adjusters are therefore asked to determine or estimate the amount of loss. The insured, on the other hand, is not bound to accept the damage claim decided upon by the adjuster, in which case some other expediency must be resorted to. Possibly accountants and appraisers may have to be employed or some equitable plan of settlement decided upon. Sometimes the courts are resorted to for decisions. Insurance companies usually reserve the right to replace or rebuild damaged property in case reasonable cash settlements cannot be made. The companies are interested in preventing loss by fire, and therefore maintain in large cities what are known as "fire patrol," "underwriters' patrol," "salvage corps," etc. It is their duty to visit the scene of the fire and to save as much property as possible. The expense of maintenance is met by the different companies, and their equipment is in every way adapted to salvage duty. Salvage has reference to the goods saved from loss by fire; in this example it amounts to $2,500. It is presumed, of course, that the books and records have all been secured.

The aggregate insurance carried is $100,000, which is considerably above the value of property owned at the time of the fire. Sometimes a blanket or open policy not to exceed a specified amount is made out to cover the value of goods on hand at any time. This is desirable where goods are not maintained at any fixed amount or quantity, and in case of fire the amount of loss must be determined. It seems evident that the case under consideration includes the open policy, though it is probable that an ordinary policy had been taken out on machinery and fixtures. The 80% co-insurance clause requires that at least 80% of the cash value

of the property covered by the policies at the time of the fire be insured. If such proportion is carried the insurance companies will pay the full amount of the fire loss up to the face value of the policies. If the required 80% of insurance is not carried, the company will only pay such part of the loss as the amount of insurance carried bears to the 80%. The owner in that case carries the remaining risk himself; that is, he becomes a co-insurer with the insurance company. For example, if property worth $100,000 is insured under the 80% clause for $70,000 and a loss of $30,000 occurs, the insurance company would be required to pay damage claims to the extent of $26,250. We get this by taking 70/80 of the claim of $30,000.

The problem calls for only a statement of fire claim against the insurance companies, which is presented herewith, but we have added a profit and loss statement and balance sheet. These will add to the value of the answer as a lesson in accountancy. The statement of claim would no doubt be accompanied by the accountant's letter to the client who engaged his services.

Statement of Claim for Loss by Fire, September 16, 1912.

Value of merchandise inventory Aug. 1, 1912			$ 42,618.97
Merchandise purchases between Aug. 1, 1912, and Sept. 16, 1912.			103,430.22
Total merchandise			$146,049.19
Add Manufacturing Charges:			
Labor paid		$37,619.14	
Power, light and heat		3,716.47	
Factory expense		7,119.11	48,454.72
Total cost of merchandise			$194,503.91
Deduct cost of goods sold			135,764.43
Sales $162,917.31 ÷ 120.			
(The gross profit has been uniform for several years at 20%.)			
Value of merchandise destroyed			$ 58,739.48
Add value of properties destroyed:			
Machinery, book value Aug. 1, '12	$20,419.04		
Additions between Aug. 1 & Sept. 16	1,200.30	$21,619.34	
Less salvage retained		2,500.00	19,119.34
Furniture and fixtures, value Aug. 1, 1912	$2,000.00		
Additions between Aug. 1 & Sept. 15	147.30		2,147.30
Total damage claim			$ 80,006.12

Certificate.

I hereby certify that the above statement of claims is in accordance with the books, and that in my judgment it represents a fair basis for settlement.

R. J. BENNETT,
Certified Public Accountant.

September 18, 1912.

Balance Sheet.

As on Sept. 16, 1912, after Adjustment of Fire Loss with the Insurance

Assets.

Cash	$ 5,418.22	
Accounts receivable	118,871.14	
Bills receivable	6,217.24	
Machinery, salvage valuation	2,500.00	
Claims for fire loss against insurance companies	80,006.12	
Total assets		$213,012.72

Liabilities.

Accounts payable	$ 72,898.66	
Bills payable	63,114.02	
Total liabilities		136,012.68
Present net capital of Company		$ 77,000.04

Analysis of Capital Account.

Capital stock paid up		$ 50,000.00
Surplus Aug. 1, 1912	$14,203.16	
Less dividends paid	6,000.00	8,203.16
Net profit for 1½ months		18,796.88
Present capital		$ 77,000.04

Note.—The books should be adjusted to agree with the results shown above.

Operating and Profit and Loss Account

From August 1, 1912, to September 16, 1912.

Credits.

Sales for 1½ months	$162,917.31
Fire claim appraised by insurance companies for goods destroyed	58,739.48
Fire claim for machinery, appraised	19,119.34
Fire claim furniture and fixtures, appraised	2,147.30
Total credits	$242,923.43

Charges.

Merchandise inventory Aug. 1, 1912	$ 42,618.97	
Merchandise purchases	103,430.22	
Labor	37,619.14	
Power, light and heat	3,716.47	
Factory expense	7,119.11	
Cost of merchandise	$194,503.91	
Office salaries	2,250.00	
Office expenses	319.54	
Selling expenses	4,716.92	
Insurance	318.16	
Taxes	751.38	
Fire loss, furniture and fixtures	2,147.30	
Fire loss, machinery	19,119.34	
Total charges		$224,126.55
Net profit		$ 18,796.88

MISCELLANEOUS MATTERS.

Problem No. 1.

A COAL mining corporation proposes to issue bonds of the denomination of $1,000 each to the amount of $500,000 on January 1, 1911, bearing interest at 6 per cent per annum, payable semi-annually. Under the terms of the mortgage a fund equal to 10 cents per ton of coal shipped is to be set aside semi-annually for the first three years, and at the rate of 12 cents per ton thereafter, the fund to be used as follows:

First—To pay the interest on the bonds.

Second—After paying interest the balance is to be used to redeem and cancel bonds at par as of the dates on which the interest is paid; any balances remaining in the fund thereafter to be added to the fund of the next period.

It is estimated that the tonnage will be 400,000 tons each six months for the first three years, and 500,000 tons each six months thereafter.

Prepare a tabular statement showing concisely the operation and the result of the carrying out of the proposed plan based on the foregoing estimates.

Answer.

The following tabulated analysis shows the operations and output of the coal mine and the various transactions in connection with Bond Interest and Bond Payments. It will be seen that the final payment on account of bonds was made on July 1, 1917, including the interest on same for six months, $510.00. This leaves a balance of $43,480.00 in the Bond Fund, which may remain therein or be transferred to Surplus Account.

Tabulated Statement of Operations and Bond Payments from July 1, 1911, to July 1, 1917.

Year	Output Tonnage.	Bond Fund.	Disposition of Fund.				Bal. Bond Acct.
			Interest	Bal	Bonds Paid.	Bal. Fund.	
Bond Issue							500,000.00
1911–1	400,000	40,000.00	15,000.00	25,000.00	25,000.00	....	475,000.00
" –2	400,000	40,000.00	14,250.00	25,750.00	25,000.00	750.00	450,000.00
1912–1	400,000	40,000.00	13,500.00	26,500.00	27,000.00	250.00	423,000.00
" –2	400,000	40,000.00	12,690.00	27,310.00	27,000.00	560.00	396,000.00
1913–1	400,000	40,000.00	11,880.00	28,120.00	28,000.00	680.00	368,000.00
" –2	400,000	40,000.00	11,040.00	28,960.00	29,000.00	640.00	339,000.00
1914–1	500,000	60,000.00	10,170.00	49,830.00	50,000.00	470.00	289,000.00
" –2	500,000	60,000.00	8,670.00	51,330.00	51,000.00	800.00	238,000.00
1915–1	500,000	60,000.00	7,140.00	52,860.00	53,000.00	660.00	185,000.00
" –2	500,000	60,000.00	5,550.00	54,450.00	55,000.00	110.00	130,000.00
1916–1	500,000	60,000.00	3,900.00	56,100.00	56,000.00	210.00	74,000.00
" –2	500,000	60,000.00	2,220.00	57,780.00	57,000.00	990.00	17,000.00
1917–1	500,000	60,000.00	510.00	59,490.00	17,000.00	43,480.00	....
	5,900,000	66,000.00	116,520.00	....	500,000.00		

July, 1917, Balance of Bond Fund, Surplus Profits, $43,480.00.

Problem No. 2.

A public service corporation known as "A" acquires 51 per cent of the capital stock of "B," a similar corporation. Subsequently, on January 1, 1901, it enters into a 99-year lease of the property of "B," thus securing a right to the full enjoyment of all the income and earnings of "B" during the period of the lease, and agreeing to pay by way of a rental therefore a sum sufficient to provide a 6 per cent annual dividend upon "B's" capital. Among the assets acquired under the lease were 1,000 shares (par value $100 per share) of the stock of "C" corporation. On July 1, 1902, "C" paid a 10 per cent stock dividend and gave its stockholders the right to purchase at par a further amount of stock equal to 20 per cent of their holdings on June 30, 1902, which right was exercised by "A." Dividends at the rate of 7 per cent per annum were paid by "C" during the entire period under discussion. On July 1, 1909, "A" sold all its holdings in the stock of "C" company at $150 per share and received payment therefor in cash. Assuming that the stock dividend mentioned above should be treated in the same manner as the cash dividends and that for ease of demonstration all of "A's" transactions other than those recited above as growing out of the acquisition of the shares in "C" company's stock had been suspended during the period.

(a) State the method of treatment in "A's" accounts of the stock of "C" when acquired as lessee on January 1, 1901.

(b) Prepare a balance sheet for "A" as at December 31, 1909, showing how you would state the results of the foregoing transactions, having in mind especially "A's" relation to "B."

Solution.

It is a common practice for large corporations, such as railroads, public service corporations and industrial companies, to lease and operate the properties and equipments of other companies. The contract entered into when such a lease is made depends upon the terms thereof and upon the mutual arrangements between the companies. Such leases are usually drawn with great care and specify clearly and distinctly the relationship existing between the companies, the maintenance and equipment of properties, the matter of additions and betterments, the handling of income and expenditures, the disposition of assets and liabilities, funded debts, etc.

This lease and the minutes of the Board of Directors give the accountant the information he desires when placing upon the books the proper entries and records. When the lease is made the lessee company does not necessarily take over any of the accounts of the leased company, in which case they continue to be carried on the leased company's books. In that case there are no entries to be made on either company's books at the time of executing the contract. The operating company continues to carry on business as before and to keep its own accounts, and regular reports are made to the lessee company showing the results of operations, etc. The net income from operations, of course, goes to the lessee company. Any expenditures made by the lessee on account of the lessor are charged to it and reimbursement made later except for operating expenses.

The contract not infrequently provides that the lessee company is to take over all current assets and assume the current liabilities, and after settlement of current assets and liabilities the balance due to or by the lessee company may be adjusted on its own books or else entered to the account of the lessor company; then again the lessee company may take over the entire assets and liabilities and credit the balance thereof to the lessor company's account. At the expiration of the lease, of course, the fixed properties still intact would be handed back to the lessor company, but it is probable that the current assets and liabilities taken over at the beginning may long since have been eliminated. Additions and betterments to leased properties are usually charged against the lessor company and reimbursements made at a later date.

In the question under discussion there are three corporations concerned, two of which hold stock in other companies, and one of which leases and operates one of the other companies. Company "A" owns a majority of the stock of company "B," thus giving it a controlling interest therein and the right to dictate its business policies. It exercises this right by acquiring the property of "B" under lease for a long term of years, thereby assuming direct control of its operations and the right to enjoy all income from its earnings and investments. In return for this privilege it guarantees to the stockholders of "B' 'a 6 per cent dividend.

We will assume that "A" took over the current assets and liabilities of "B," and that it has acquired the ownership and control of all the current assets. Therefore the securities of "C" which are held by "B" are acquired and have become the property of "A," thus giving "A" the right to dispose of them at any time.

On July 1, 1902, "C" declared a cash dividend of 7 per cent (and the same was declared each year thereafter) and also a stock dividend of 10 per cent. Having acquired "B's" ownership in the stock of "C," "A" is entitled to this income. Even if "A" had not acquired the full ownership of "B's" current assets it would be entitled to these two dividends, since the question states that both stock and cash dividends are to be "treated in the same manner"—considered as income. The right to purchase 20 per cent of "B's" holdings in "C" company would accrue to "A" under our assumed plan and would be computed on the 1,000 shares owned on June 30, 1902, before the stock dividends had been declared. In case "B" had retained the ownership of its assets then it, and not "A," would have the right to subscribe for and hold said $20,000.000 of additional investment. The sale of stock of "C" on July 1, 1909, would consist of "A's" entire holdings of 1,300 shares, for the sum of $195,000.00, thereby netting a profit to "A" of $65,000.00. The book entry in this case would debit cash for the entire amount, $195,000.00, and credit securities for $130,000.00 and income account for $65,000.00. Then the balance sheet required as on Dec. 31, 1909, would not show the transactions covering the investments in "C" company's stock, but would exhibit the usual accounts of "A" and any remaining current assets and liabilities of "B," or charges against "B's" account. The remaining assets or liabilities of "B" would undoubtedly be merged with the current accounts of "A" and not shown separately. In case of bonds or other obligations assumed, they would be shown separately as a liability, and a corresponding charge against "B" as an offsetting asset.

(a) On the assumption that "A" on Jan. 1, 1901, took over the current assets and liabilities of "B" we have the first entry shown below. The assumed balance to "B's" credit may be liquidated later, but it often happens that the liabilities are the larger.

We will also assume that "B" had a bond issue of $100,000.00 outstanding and which "A" assumed, giving an entry similar to the second.

(b) For the purpose of showing a balance sheet we assume values to complete a suitable exhibit. Any of the current assets or liabilities of "B" still remaining are merged into the accounts of "A" excepting the guaranteed bond issue with its equivalent offset among the assets. Agreements other than those assumed, as stated above, would necessarily modify the arrangement with reference to the relations existing between "A" and "B."

Current Assets	$135,000.00	
Investments (C Stock)	100,000.00	
To Company B		$235,000.00
For current assets taken over as per contract.		
Company "B"	115,000.00	
To Current Liabilities		115,000.00
For obligations of "B" assumed as per contract.		
Leasehold interest Company B	$100,000.00	
To Guaranteed Bonds		$100,000.00
For issue of 5% bonds of "B" due 1930, guaranteed per contract.		

A's Balance Sheet December 31, 1909.

ASSETS.		LIABILITIES.	
Plant and Premises	$ 350,000.00	Capital Stock	$ 500,000.00
Machinery and Equipment	250,000.00	Sinking Fund Bonds, 5%	200,000.00
Investments:		Guaranteed Bonds of Company B	100,000.00
Company B Stock. $ 51,000		Sinking Fund Reserve	125,000.00
In other Co.'s 100,000	151,000.00	Replacement and Renewal Fund	75,000.00
Current Assets, Supplies, etc.	264,000.00	Current Liabilities	150,000.00
Sinking Fund: For redemption of outlying bonds	125,000.00	Surplus Fund	40,000.00
Leasehold Interest in Co. B.	100,000.00	Net Revenue	50,000.00
	$1,240,000.00		$1,240,000.00

Problem No. 3.

"A" and "B" are partners carrying on a business in Winnipeg. On January 1, 1910, after adding profits for the past half year, "A's" capital amounted to $150,000, and "B's" to $100,000. On that date they take into partnership "C" upon the following terms, viz.: He is to bring in capital amounting to $25,000, and each partner is to be credited with interest on his capital at 6 per cent per annum. All profits (after debiting interest) up to $25,000 are to be shared by "A" and "B" exclusively in proportion to the amounts of their capital at January 1, 1910. All profits in excess of $25,000 are to be shared equally by the three partners. Accounts are to be prepared and profits and interest credited half-yearly. "C" is to be credited with a salary of $5,000 per annum. On June 30, 1910, the profits divisible after debiting "C's" salary, which he has drawn, but before charging interest on partner's capital, amounted to $75,000. The partners' withdrawals, which are not chargeable with interest, were: "A," $12,500; "B," $10,000, and "C," $3,750. Draw up partners' separate accounts as they should stand on July 1, 1910.

Assume that instead of a profit a loss of $75,000 has occurred. How would you have treated it in the accounts in the absence of any direct provision in the partnership agreement relative to losses?

Solution.

The following capital accounts and profit and loss accounts are clear enough without additional comment. "C's" salary of $2,500.00 for the half-year is credited as per contract, and his drawings are assumed to have included this amount.

In the event of a loss of $75,000.00, as suggested in the question, this amount plus interest on capital aggregating $83,250.00 would be charged in equal proportions to the three partners, giving to each $27,750.00. This is on the assumption that no direct provision has been made in reference to losses. Each partner would of course be credited with interest on capital per agreement. With reference to the assumed loss, if the existing agreement between the partners implied a similar application in case of losses, then the matter of apportioning said losses would provide an interesting problem.

A's Account.

1910			1910		
June 30	Cash	$ 12,500.00	Jan. 1	Balance	$150,000.00
" 30	Balance	170,916.67	June 30	Interest	4,500.00
			" 30	Gain	15,000.00
				"	13,916.67
		$183,416.67			$183,416.67
			July 1	Balance	$170,916.67

B's Account.

1910			1910		
June 30	Cash	$ 10,000.00	Jan. 1	Balance	$100,000.00
" 30	Balance	116,916.67	June 30	Interest	3,000.00
			" 30	Gain	10,000.00
				"	13,916.67
		$126,916.67			$126,916.67
			July 1	Balance	$116,916.67

C's Account.

1910			1910		
June 30	Cash	$ 3,750.00	Jan. 1	Cash	$ 25,000.00
" 30	Balance	38,416.66	June 30	Salary	2,500.00
			" 30	Interest	750.00
			" 30	Gain	13,916.66
		$42,166.66			$ 42,166.66
			July 1	Balance	$ 38,416.66

Distribution of Profits June 30, 1910.

Profits for distribution		$75,000.00
Less Interest on Capital:		
Interest due A	$ 4,500.00	
Interest due B	3,000.00	
Interest due C	750.00	8,250.00
Balance for distribution		$66,750.00
Deduct amounts due A and B:		
Due A 3/5 of 25,000	$15,000.00	
Due B 2/5 of 25,000	10,000.00	25,000.00
Balance for equal division		$41,750.00
A's 1/3 share	$13,916.67	
B's 1/3 share	13,916.67	
C's 1/3 share	13,916.66	41,750.00

Problem No. 4.

A fire insurance company began business with a capital of $400,000, a surplus of $400,000 paid in cash. At the end of the year its books show the following:

Income.

Gross premiums, $707,135.84; less re-insurance rebates and return premiums, $94,971.27; interest on mortgage loans, received in cash, $6,803.65, and interest accrued and due, $1,349.87; interest on collateral loans, received in cash, $1,014.44, and accrued and due, $4,228.32; interest on bonds and dividends on stocks, received in cash, $16,841.65, and accrued and due, $186.00; profit on sale of assets, $4,204.52.

Outgo.

Gross amount paid for losses, $115,048.22; less salvages, $14,900; gross claims for losses in process of adjustment, $32,263.83; gross claims for losses resisted, $8,618.50; less due and accrued for re-insurance, $11,412.71; commissions on brokerage, paid in cash, $123,544.19, and due or to become due, $9,519.24; salaries, fees and all other charges of officers, clerks and other employes paid, $24,755.68; rents paid, $4,224.93; taxes, licenses, insurance department fees paid, $9,764.99; all other expenses paid, $20,820.12; due and accrued expenses, $621.29; due and accrued return premiums, $9,597.36; due and accrued re-insurance premiums, $6,856.48. The market value of securities owned was $20,625 less than their cost.

The risks in force at the end of the year carried premiums of $580,867.07, of which sum $424,747.65 was the aggregate premiums on risks running one year or less, and $156,119.42 was on risks running more than one year, the unearned premiums on which amounted to $111,950.46.

Set up the income accounts, making due allowance for unearned premiums.

Solution.

Income.

Gross premiums	$707,135.84	
Less re-insurance, rebates and return premiums	94,971.27	
		$612,164.57
Interest on mortgage loans:		
Cash	$ 6,803.65	
Accrued and due	1,349.87	
		8,153.52
Interest on collateral loans:		
Cash	$ 1,014.44	
Accrued and due	4,228.32	
		5,242.76
Interest on bonds and dividends on stocks:		
Cash	$ 16,841.65	
Accrued and due	186.00	
		17,027.65
Profit on sale of assets		4,204.52
Total income		$646,793.02

Outgo.

Gross losses paid		$115,048.22	
Less salvages		14,900.00	
			$100,148.22
Gross losses in process of adjustment'	$32,263.83		
Gross losses resisted	8,618.50		
		$ 40,882.33	
Less due and accrued for re-insurance		11,412.71	
			29,469.62
Commissions:			
Paid in cash		$123,544.19	
Due or to become due		9,519.24	
			133,063.43
Salaries, fees, etc., of officers and clerks, paid			24,755.68
Rents paid			4,224.93
Taxes, licenses and insurance dept. fees paid			9,764.99
All other expenses:			
Paid		$20,820.12	
Due and accrued		621.29	
			21,441.41
Returns, premiums, due and accrued			9,597.36
Re-insurance premiums, due and accrued			6,856.48
Depreciation in value of securities			20,625.00
			$359,947.12
Premiums on risks running one year or less	$424,747.65		
Unearned premiums, 50%		$212,373.82	
Premiums on risks running more than one year	$156,119.42		
Unearned premium		111,950.46	
Total unearned premium			324,324.28
Total outgo			$684,271.40
Total income			646,793.02
Net decrease in surplus			$ 37,478.38

Comments.

According to the laws of New York State a reserve is required of the full premium for the average proportion of time unexpired, without any deduction for the expenses which have been prepaid at the outset, and where there is the usual proportion of long-term policies this brings out an average reserve on the total premium of as much as 75%. As the result, a new company established in the United States incurs a serious risk of having its license withdrawn by the authorities at the end of the first year in consequence of impairment of capital, unless it has adopted the necessary precaution of requiring its shareholders to pay up a substantial sum as reserve in addition to the paid-up capital.

Problem No. 5.

The trial balance of Jones & Smith, Chicago branch, shows Dec. 31 the following:

Home office	.....	$2,000
Due from customers	$2,500	.....
Cash on hand	1,000	.....
Expenses	1,900	.....
Merchandise	.....	3,400
	$5,400	$5,400

Inventory, $1,000.

Draft the necessary journal entries to close the accounts on the branch books and the entries to be made in the home office, to make the books agree.

Solution.

A.

Chicago Branch Books—Journal entries:

Profit and loss	$1,900	
To expenses		$1,900
Merchandise	$3,400	
Stock on hand	1,000	
To profit and loss		$4,400
Profit and loss	$2,500	
To home office account		$2,500

Net profits for the period transferred to home office account.

Ledger Accounts—After Closing.

Home Office Account.

Dec. 31—Balance	$2,000
31—Profits	2,500
	$4,500

Merchandise Account.

Dec. 31—Stock on hand $1,000

Cash Account.

Dec. 31—Cash on hand $1,000

Customer's Controlling Account.

Dec. 31—Balance $2,500

Balance Sheet, as at Dec. 31.

ASSETS.		LIABILITIES.	
Cash	$1,000	Home office account:	
Customers	2,500	Balance	$2,000
Stock in trade	1,000	Profits	2,500
	$4,500		$4,500

Profit and Loss Account.

Expenses	$1,900	Mdse. account	$3,400
Profits, transferred	2,500	Stock on hand	1,000
	$4,400		$4,400

B.

Home Office Books—Journal entries:

Chicago trading account		$1,900	
To Chicago Branch account			$1,900
Chicago Branch account		$4,400	
To Chicago trading account:			
Merchandise	$3,400		
Stock on hand	1,000		$4,400
Chicago trading account		$2,500	
To general profit and loss account			$2,500
Being profits on Chicago Branch.			

Chicago Branch Account.

Dec. 31—To balance	$2,000	Dec. 31—By Chicago trading acct.	$1,900
31—To Chicago trading acct.	4,400	31—By balance down:	
		Cash $1,000	
		Customers 2,500	
		Stock in trade 1,000	
			$4,500
	$6,400		$6,400
Jan. 1—To balance	$4,500		

Chicago Trading Account.

Dec. 31—To Chicago branch acct.	$1,900	Dec. 31—By Chicago Branch mdse.	$3,400
31—Expenses: General profit and loss account	2,500	31—By Chicago Branch stock	1,000
	$4,400		$4,400

General Profit and Loss Account.

		Dec. 31—By Chicago trading acct.	$2,500

Comments.

From the Chicago branch trial balance submitted it is assumed that the Chicago branch keeps a complete and independent set of books, conducting all its business on independent lines, only making remittances on receiving funds from the home office as occasion demands. The branch will open an account called "Home office account," crediting thereto the goods and cash received, corresponding accounts being debited.

It will also open a "Home office remittance account," to which all remittances sent home will be debited.

It will thus be seen that the "Home office account" in the branch books corresponds to the capital account of a sole proprietor, and the "Home office remittance account" resembles the drawing account.

In the home office books an account will be opened, "Branch No. 1 account," to which will be debited the goods or cash originally and subsequently sent.

Fixed assets are usually not recorded in the branch books; an account is opened in the home office general ledger for the same.

Remittances received from the branch office will be credited to "Branch No. 1 remittance account;" at the end of the period it will be closed into "Branch No. 1 account."

The objects to be kept in view when constructing a system for branch house books will be:

1. The control and supervision of the branch transactions.
2. The production of accounts showing profits or losses on each branch.
3. The presentation of the results in such form that comparisons can easily be made.

In the general balance sheet the $4,500 debit balance of Chicago branch account can either be shown among the assets as excess of branch assets over liabilities, or, in other words, "balance due by the branch," or the various assets and liabilities at the branch can be stated separately, the latter mode being preferable, as it more truly represents the position of the branch.

Problem No. 6. Dec - 1915

A ships to B on consignment, under date of April 4, merchandise to the value of $1,500, paying $15 cartage and $6 insurance.

B receives the consignment April 20, paying freight $70 and cartage $12. He subsequently disposes of the merchandise by sale as follows: April 30, $400; May 30, $800; June 30, $600; on which latter he pays storage charges, $30. He charges commissions on sales 5%, ~~credits net interest at 6%~~ and transmits account sales with remittance of net proceeds to A, who receives them July 10. Interest to be charged & credited on a/c @6%

Prepare shipment account as appearing on A's ledger and consignment account as appearing on B's ledger.

Solution.

"B" Consignment Account (A's Ledger).

Apr. 4—To mdse.	$1,500.00	July 10—By "B," account sales	$1,800.00
4—To cartage	15.00		
4—To insurance	6.00		
July 10—To freight, account "B"	70.00		
10—To cartage, acct. "B"	12.00		
10—To storage, acct. "B"	30.00		
10—To commission, 5%	90.00		
10—To profits	77.00		
	$1,800.00		$1,800.00

"B" Account.

July 10—To consignment acct.	$1,800.00	July 10—By freight	$ 70.00
10—To interest	11.10	10—By cartage	12.00
		10—By Storage	30.00
		10—By commission	90.00
		10—By interest	1.50
		10—By net proceeds	1,607.60
	$1,811.10		$1,811.10

Interest Account.

Apr. 20—To "B," on advances	$ 1.50	July 10—By "B"	$11.10
81 days, $112, at 6%.		Per account sales, 6%:	
July 10—To profit and loss	9.60	Apr. 30—$400, 71 days. $4.72	
		May 30—$800, 40 days. 5.36	
		June 30—$600, 10 days. 1.02	
	$11.10		$11.10

Profit and Loss Account.

		July 10—By consignment account "B"	$77.00
		10—By interest	9.60
			$86.60

"A" Consignment Account (B's Ledger).

Apr. 20—To "A"	$1,500.00	Apr. 30—By sales	$ 400.00
June 30—To "A," profits	300.00	May 30—By sales	800.00
		June 30—By sales	600.00
	$1,800.00		$1,800.00

"A" Account.

Apr. 20—To freight	$ 70.00	Apr. 20—By consignment	$1,500.00
20—To cartage	12.00	June 30—By profit	300.00
20—To storage	30.00	July 8—By interest	11.10
June 30—To commission, 5%	90.00		
July 8—To int. on advances	1.50		
8—To net proceeds	1,607.60		
	$1,811.10		$1.811.10

Comments.

A consignment account is an account kept in respect of goods sent to an agent for the purpose of sale on commission in order to ascertain the profit or loss on the transaction. It is a temporary trading account.

Goods should be charged to this account at cost, but it is the practice in many cases to invoice at cost plus a percentage, which percentage, of course, has to be allowed for in ascertaining the final result. This method is frequently adopted in order to prevent the agent from knowing the cost price.

The following entries will require to be made in the consignor's books:

1. Debit consignment account and credit the goods on consignment account with the cost price on the goods.

2. Debit consignment account and credit cash or the creditor with any expenses incurred in connection with those goods by the consignor.

3. If the consignor closes his accounts prior to such goods being sold, the balance of the consignment account will be treated as stock on consignment, and the credit balance standing to the goods on consignment account written off to the credit of the trading account.

4. As soon as the consignor receives from the consignee an account sales he will

(a) Debit the consignee's personal account and credit consignment account with the gross proceeds..

(b) Debit consignment account, credit the consignee's personal account with any expenses incurred by the consignee on his behalf, together with the agreed commission charged by the consignee.

5. The balance of the consignment account will then represent the profit or loss on that particular consignment of goods.

6. The balance of the consignee's personal account will represent the amount owing by him to the consignor and will be closed by net proceeds remitted.

The consignee's personal account is often debited and the consignment account credited with the net proceeds of the goods, but this is not recommended, inasmuch as the consignment account will not show in this case the whole of the details as disclosed by the account sales.

The treatment of *interest* involved calls for some attention. The best way is to close the consignment account into profit and loss, then show the interest in an account of that name, to be closed out into profit and loss; thus the profit on merchandise and interest will show separately.

The consignee again records his transactions as follows:

1. Debit "consignment from X account" and credit the consignor's personal account for value of goods received.

2. Debit consignee's customers for goods sold and credit "consignment from X account" with corresponding amounts.

3. Transfer the balance of the "consignment to X account" to the consingnor's personal account, showing the merchandise profits.

4. Debit consignor's personal account with all expenses incurred, commissions inclusive, and credit corresponding accounts on the consignee's books.

5. The balance of consignor's account will then represent the amount due from the consignee and will be closed by net proceeds remitted.

Note.—Some accountants favor this method:

The consignee debits his customer and credits the consignor for the sale, because the consignee is liable to the consignor for the proceeds which he will receive from his customer. Selling goods for cash, the consignee simply debits cash and credits the consignor.

By this method, the "consignment from X account" is omitted.

Problem No. 7.

A malting company was placed in the hands of a receiver in bankruptcy. The assets inventoried by the receiver were:

Accounts receivable	$218,477.15
Grain and products in malt house	29,359.74

An order of the court was entered instructing the receiver to continue the operation of the business. After the receiver had operated the business two months, a settlement was effected, and the receiver discharged by the court, the bankrupt company resuming business. The receiver's books of the bankrupt company's accounts showed at the date of his discharge:

Collections on account of the accounts receivable inventoried above $10,097.60; they showed that in trade the receivers had made gross sales to the amount of $114,806.62; his grain purchases were $110,786.61; manufacturing expense, $7,279.07; selling expense, $7,956.97; receiver's charges, $1,000; discounts, shortages and merchandise returned, $1,370.85; on hand in grain and products, $51,005.62; he has collected in cash on receiver's sales, $65,448.83; he owes an open account of $5,237.52; borrowed from banks, $46,251.10.

Prepare trading statement showing profit or loss from receiver's operations, and prepare final balance sheet statement from the face of the receiver's accounts of the bankrupt company at the close of his receivership.

Solution.

First and Final Account of A. Brown, **Receiver.**
The Excelsior Malting Co., Chicago.
November 3, 1910.

Copy of inventory of The Excelsior Malting Co. at the commencement of Receivership September 1, 1910.

	Book value	Estimated value
Accounts receivable	$221,900 Sc. A1	$218,477.15 Sc. A3
Grain and products in malthouse	32,000 Sc. A2	29,359.74 Sc. A4
Total	$253,900	$247,836.89

Trading Statement, November 3, 1910.

Income.

Sales, per schedule M, part 1		$114,806.62
Less:		
Discounts, shortages and merchandise returned, schedule B, part 2		1,370.85
Total net sales		$113,435.77
Deduct:		
Cost of merchandise sold, per statement below		99,060.06
Gross profits		$ 14,375.71
Inventory at beginning, schedule A, part 2	$ 32,000.00	
Purchases, schedule C	110,786.61	
Manufacturing expense, schedule D, part 1	7,279.07	
	$150,065.68	
Less:		
Stock-in-trade, Nov. 30, 1910, schedule E	51,005.62	
	$ 99,060.06	

Expenditures.

Selling expenses, per schedule D, part 2	$ 7,956.97	
Receiver's charges, per schedule D, part 3	1,000.00	
		8,956.97
Leaving net profits from receiver's operations		$ 5,418.74

Final Balance Sheet at Close of Receivership, November 3, 1910.

Assets.

Accounts receivable, schedule K		$259,789.34
Viz:		
Outstanding accounts at beginning, schedule A, part 1	$221,900.00	
Sales, schedule B, part 1	114,806.62	
	$336,706.62	

Deduct:			
Collected old accounts	$10,097.60		
Collected new accounts	65,448.83		
Schedule F	1,370.85		
		$ 76,917.28	
Sc. B, part 2		$259,789.34	
Stock-in-trade, schedule E			$ 51,005.62
Cash on hand, per cash account			12.40
Total assets			$310,807.36

Liabilities.

Notes payable, schedule G	$ 46,251.10	
Open creditors, schedule H	5,237.52	
		51,488.62
Balance		$259,318.74

Summarized Statement of Receipts and Disbursements.

Receipts.

Accounts receivable, old	$ 10,097.60	
Accounts receivable, new (per schedule F)	65,448.83	
Notes payable (per schedule G)	46,251.10	
Total receipts		$121,797.53

Disbursements.

Manufacturing expenses (per schedule D, part 1)	$ 7,279.07	
Selling expenses (per schedule D, part 2)	7,956.97	
Creditors (per schedule I)	105,549.09	
Receiver's charges (schedule D, part 3)	1,000.00	
Total disbursements		121,785.13
Cash on hand		$ 12.40

Comments.

As to the final statement of assets and liabilities at the close of the receivership the real financial condition of the malting company cannot be ascertained from the facts given in the question under review.

Only assets are given at the beginning of the receivership; a statement of liabilities owing previous to the appointment of the receiver is omitted in the question. Hence, as stated above, the net capital of the concern at the end of the receivership cannot be determined.

In showing the accounts of a receiver it is almost impossible to give a suppositious case, as would be done in an executor's account.

Problem No. 8.

The American Gas Light Company had operated a gas plant since the beginning of the year 1906. For the purpose of acquiring this industry, the National Gas Company was organized April 1st, 1909, with a capital of $100,000, and after purchasing all of the capital stock of the American Company, issued $100,000 of first mortgage 6 per cent gold bonds, dated April 1st, 1909, due April 1st, 1939, interest payable January 1st and July 1st of each year.

In acquiring the stock of the American Company, paying organization expenses, etc., the National Company used all its capital stock and $90,000, first mortgage bonds, holding in reserve $10,000 of bonds for improvements.

Make the necessary journal entries to open the books of the new company and prepare a balance sheet dated June 30, 1909.

Also prepare a profit and loss account showing the average annual results of the operations of the old company.

The inventory was as follows: Coal, 400; coke, 150; tar, 100. Total, 650.

January 30, 1909, the two companies were united by a certificate of merger and new books were opened. The accounts of the American Gas Light Company had not been closed at any time during that company's existence, and at the date of the merger stood as follows:

DEBITS.		CREDITS.	
Land, Buildings, Machinery, Mains and Franchises	$ 82,360.73	Capital	$ 50,000.00
Materials and Tools	1,856.30	Bills Payable	5,000.00
Coal (including freight)	47,540.45	Accounts Payable	2,679.81
Labor	50,668.73	Gas Account	157,683.33
Repairs	13,872.46	Coke Account	6,210.69
Water and Supplies	3,869.39	Tar Account	4,500.54
Superintendence	3,500.00		
Salaries (clerks and collectors)	5,600.00		
Office Expenses	2,100.00		
Insurance	1,435.00		
Taxes	4,237.10		
Interest	1,450.40		
Cash	2,251.47		
Consumers' Accounts	3,210.44		
Other Accounts Receivable	2,121.90		
	$226,074.37		$226,074.37

SOLUTION.

Manufacturing Account, June 30, 1909.

Coal		$ 47,540.45	Manufacturing Cost transferred to Trading Account	$124,473.13
Labor		50,668.73		
Repairs		13,872.46		
Water		3,869,39		
Superintendence		3,500.00		
Insurance		1,435.00		
Taxes		4,237.10		
		$125,123.13		
Less Inventories:				
Coal	$400			
Coke	150			
Tar	100			
		650.00		
Manufacturing Cost		$124,473.13		$124,473.13

Trading Account.

Manufacturing Cost	$124.473.13	Sales	$157,683.33
Gross Profits to P. & L. Account	43,921.43	Gas Account	6,210.69
		Coke Account	4,500.54
	$168,394.56		$168,394.56

Profit and Loss Account.

Salaries	$ 5,600.00	Gross Profits	$ 43,921.43
Office Expenses	2,100.00		
	$ 7,700.00		
Ordinary Business Profits, balance down	36,221.43		
	$ 43,921.43		$ 43,921.43

Net Profits Account.

Interest	$ 1,450.40	Balance down	$ 36,221.43
Net Profits to surplus account	34,771.03		
	$ 36,221.43		$ 36,221.43

Balance Sheet of Old Company After Closing Books.

Land, Buildings, Machinery, Mains and Franchises	$ 82,360.73	Bills Payable	$ 5,000.00
Materials and Tools	1,856.30	Accounts Payable	2,679.81
Inventories	650.00	Capital Stock	50,000.00
Consumers' Accounts	3,210.44	Surplus	34,771.03
Other Accounts Receivable	2,121.90		
Cash	2,251.47		
	$ 92,450.84		$ 92,450.84

Opening Entries of New Company.

Sundry Assets, as per balance sheet	$ 92,450.84	To Liabilities, as per balance sheet	$ 7,679.81
Capital Stock: Old Company under merger. This is new treasury stock of new Company	50,000.00	To Capital Stock, new	100,000.00
Treasury Bonds	10,000.00	To Capital Stock, old	50,000.00
Organization Account	106,578.97	To Bonds	90,000.00
		To Interest on Bonds 6% on $90,000 three months	1,350.00
		Reserve Account	10,000.00
	$259,029.81		$259,029.81

Consolidated Balance Sheet, as at June 30, 1909.

Sundry Assets	$199,029.81	Liabilities	$ 7,679.81
Treasury Stock	50,000.00	Capital Stock	150,000.00
Treasury Bonds	10,000.00	Bonds	90,000.00
		Bond Interest	1,350.00
		Reserve Account	10,000.00
	$259,029.81		$259,029.81

Problem No. 9.

The "A" corporation to prevent injurious competition purchases from the "B" corporation, a competing firm, the whole of its business as a going concern on January 1, 1910, for $500,000, subject, however, to certain conditions stated below.

The "B" corporation agrees to continue trading under its old management on behalf of and at the expense of the "A" corporation until December 31, 1910, when if the profits earned amount to less than $40,000 the "A" corporation reserves to itself the right to cancel the agreement for purchase on payment of the difference between the earnings for the year and $40,000.

At December 31, 1910, the profits for the year earned by the "B" corporation amount to $50,000, and the "A" corporation actually takes over the "B" corporation, paying $450,000 in full settlement.

Criticize the following methods of treating the transaction, and state which you consider correct, giving reasons for your opinion.

(A) Debit investment account with $500,000, and credit profit and loss with $50,000 earnings.

(B) Debit investment account with $450,000.

(C) Debit investment account with $500,000 and credit Special Reserve account with $50,000.

It may be taken as an ascertained fact that the assets are fully worth $500,000 at the time of purchase by the "A" corporation.

Solution.

A.

To debit investment account $500,000 is O. K., but crediting profit and loss account with $50,000, depositing the purchase profits would be incorrect; these profits are actually artificial and could be distributed in equal installments over a number of years for the benefit of present future stockholders in order to equalize the dividends. Proposition A, therefore, will not do.

B.

This entry will not do; it does not give a clear and proper expression of the whole transaction. $450,000 would be understating the actual value ($500,000) of the investment, and it ignores the profits, $50,000, entirely; such profits must appear in some form on the books in order to show the full and correct history of the whole transaction.

C.

This entry gives the correct expression of the purchase.

1. It shows the investment at its actual value.

2. It shows a correct disposition of the profits, i. e., carried to a reserve account to be used at the pleasure of the directors, i. e., to be distributed over a number of years, available for dividends, or kept intact to strengthen the financial position of the company.

Problem No. 10.

S and T began business August 1st, 1909, S investing $8,000 and T investing $5,000, gains and losses to be shared equally and no interest allowed on investments or charged on withdrawals. The firm was dissolved May 1, 1910. The books had been kept in a haphazard fashion, but the partners agreed to the following statement which was submitted for settlement: Net debit of S, $2,100; net credit of T, $3,500; cash on hand, $3,400; 10 shares bank stock, (market value $1,100); expense debit, $5,100; profit and loss debit, $3,000; credit, $500. The bank holds the firm's note for $2,000, on which there is accrued interest of $60.

Prepare a statement showing the settlement of the partnership affairs of the firm.

Solution.

Assets.

S	$2,100.00	
Cash	3,400.00	
Bank Stock	1,100.00	
		$6,600.00

Liabilities.

T	$3,500.00	
Note and Interest	2,060.00	
		5,560.00
Net Profit		$1,040.00

S. Account.

Balance	$2,100.00	½ Net Profit	$ 520.00
		Balance	1,580.00
	$2,100.00		$2,100.00
Balance	$1,580.00		

T Account.

		Balance	$3,500.00
		½ Net Profit	520.00
		Balance	$4,020.00

Balance Sheet.

Cash	$3,400.00	Note and Interest	$2,060.00
Bank Stock	1,100.00	T Account	4,020.00
Accounts receivable, S	1,580.00		
	$6,080.00		$6,080.00

Problem No. 11.

The Smith Brewing Company, with $1,000,000 capital stock, the Young Brewing Company, with $500,000 capital stock, and the Star Brewing Company, with $400,000 capital stock, agree to consolidate as the Universal Brewing Corporation, the new company to buy all the properties of the old companies at a valuation to be fixed by appraisal, payment therefor to be made in full-paid stock of the new company, the old companies to pay off their own indebtedness.

The appraised values of the old companies are as follows:

	Real Estate and Buildings	Plant	Cash	Bills Receivable	Horses, Wagons, and Harness	Office Furniture	Total
Smith......	$680.000	$390 000	$15.000	$10.000	$4.000	$1.000	$1,100.000
Young......	327.000	160.000	3.000	6,000	3.000	1,000	500.000
Star........	126.000	71.000	1.000		1.500	500	200.000
				Total appraised value............			$1.800.000

On this valuation the Universal Brewing Corporation issued $2,000,000 of stock, shares $100 each, which was divided pro rata among the old companies on the basis of their appraised value, no fractional shares of stock to be issued, odd amounts to be paid old companies in cash.

Give journal entries necessary to set up property accounts and credit old companies with their pro rata on the books of the new company.

At the time of the consolidation the ledger accounts of the Star Brewing Company were as follows:

Real Estate and Buildings..................................	$250,000
Plant	247,000
Cash	1,000
Horses, Wagons and Harness..................................	1,800
Office Furniture	1,200
	$501,000
Capital Stock	$400,000
Bills Payable	50,000
Accounts Payable	51,000
	$501,000

Make the proper journal entries to liquidate in stock of the new company the liabilities other than capital stock, to apportion the remaining stock and cash, and to close the books of the Star Brewing Company.

Solution.

Find the pro rata amounts due each company of the $2,000,000 new stock issued in excess of the total appraised value, $1,800,000.

Smith.

11×200000÷18=$122,222.22;=$22.22 to be paid in cash.

Young.

5×200000÷18=$ 55,555.56;=$44.44 to be paid by him.

Star.

2×200000÷18=$ 22,222.22;=$22.22 to be paid in cash.

Young pays Smith and Star each $22.22 cash, and the even amount of stock of the consolidated company will stand:

Smith	$122,200+	$1,100,000=	$1,222,200
Young	55,600+	500,000=	555,600
Star	22,200+	200,000=	222,200
	$200,000+	$1,800,000=	$2,000,000

Journal Entries, Universal Brewing Corporation:

DEBITS.

Real Estate and Buildings:		
Smith	$ 680,000	
Young	327,000	
Star	126,000	
Plant:		
Smith	390,000	
Young	160,000	
Star	71,000	
Cash:		
Smith	15,000	
Young	3,000	
Star	1,000	
Bills Receivable:		
Smith	10,000	
Young	6,000	
Harness, wagons and harness:		
Smith	4,000	
Young	3,000	
Star	1,500	
Office Furniture:		
Smith	1,000	
Young	1,000	
Star	500	
Goodwill	200,000	
		$2,000,000

CREDITS.

To Smith Capital Stock	$1,222,200	
To Young Capital Stock	555,600	
To Star Capital Stock	222,200	
		$2,000,000

Journal Entries, Star Brewing Company.

DEBITS.

Consolidated Stock	$222,200.00
Cash from Young	22.22
	$222,222.22

CREDITS.

To Real Estate and Buildings	$126,000.00
To Plant	71,000.00
To Cash	1,000.00
To Horses, Wagons and Harness	1,500.00
To Office Furniture	500.00
To Profit and Loss	22,222.22
	$222,222.22

Assets transferred to Universal Brewing Company in lieu of consolidated stocks, plus $22.22 cash. Balance profit.

Profit and Loss Account	$301,000	
To Real Estate and Buildings		$124,000
To Rent		176,000
To Horses, Wagons and Harness		300
To Office Furniture		700

To close the property accounts, the losses being the difference between the book values and the appraised values, i. e., $501,000—$200,000=$301,000.

To liquidate the liabilities, other than capital stock:

Bills Payable	$ 50,000	
Accounts Payable	51,000	
To Universal Brewing Co. Stock		$101,000

1,010 Shares, par value $100, transferred to creditors in full payment of all debts as per agreement.

To close the books of the Star Brewing Company.

Old Capital Stock	$400,000.00	
To Universal Brewing Co. Stock		$121,200.00
To Cash		22.22
To Profit and Loss		278,777.78
		$400,000.00

Final Profit and Loss Account, Star Brewing Co.

Assets	$301,000.00	Consolidated Stock and Cash from Young Co.	$ 22,222.22
Shrinkage in values		Old Capital Stock to Close Books	278,777.78
		Loss Sustained	
	$301,000.00		$301,000.00

Consolidated Balance Sheet.

Assets	$1,800,000	Consolidated Stock—	
Bonus	200,000	Smith Co.	$1,222,200
		Young Co.	555,600
		Star Co.	222,200
	$2,000,000		$2,000,000

Problem No. 12.

Cotton Mill Accounting.

The A. B. C. Cotton Mill Company began its manufacturing operations on January 1, 1912. A trial balance at March 31, 1912, showed the following balances, before closing:

DEBITS.		CREDITS.	
Real estate	$ 20,000.00	Bills payable	$ 80,000.00
Mill buildings	210,512.40	Waste, bagging and ties	1,419.20
Tenement houses	18,319.90	Wages accrued	1,619.20
Machinery and equipment	314,416.65	Tenement rents	760.90
Accounts receivable	4,300.00	Accounts payable	28,888.05
Cotton	82,319.20	Cloth sales	98,325.28
Superintendence	600.00	Reserve for depreciation	6,000.00
Labor—opening, picking, carding	5,100.10	Capital stock	500,000.00
Labor—spinning and spooling	7,810.16		
Labor—weaving, day work	3,010.20		
Labor—weaving, piece work	10,416.20		
Labor—finishing	1,869.74		
Labor—cloth-room	765.00		
Mill supplies	11,011.30		
Yard and watch	512.19		
Fuel	3,019.20		
Wages—engineer and firemen	415.50		
Power purchased	920.90		
Building repairs	196.20		
Machinery repairs	17.20		
Tenement repairs	44.90		
Salary of officers	1,800.00		
Office salaries	600.00		
Stationery and office supplies	320.25		
Telephone and telegraph	60.20		
Insurance	2,845.50		
Depreciation expense	6,000.00		
Interest	1,500.00		
Prepaid freight on sales	1,605.50		
Commissions on sales	4,737.68		
Discount on sales	1,966.56		
	$717,012.63		$717,012.63

The cotton record showed cotton purchases for the quarter of 705,841 pounds (invoice weights) with claims in for shortages in amounting to 2,714 pounds. Cotton account—as shown by the ledger—includes a charge of $3,100.00 to cover a loss on cotton futures in that amount.

The inventories at March 31, 1912, were as follows:

Cotton	101,707 pounds
(Market value, at this date, was 13 cents)	
Cotton in process	165,545 pounds
(No undue accumulation of stock was found at any stage of process.)	
Finished product (cloth)	56,590 pounds
Supplies (at cost)	$4,300.10
Fuel (at cost)	1,611.25
Waste (at market value)	$4,300.10
Value of prepaid insurance was	2,425.30
Prepaid interest on notes payable	214.60
Accrued taxes were estimated at	710.20
Cloth production	366,420 pounds.

From the foregoing information prepare: (a) Manufacturing and Profit and Loss accounts for the three months ending March 31, 1912; (b) Balance sheet at March 31, 1912; (c) A summarized statement of the average cost per pound of finished product for the three months ended March 31, 1912.

Cotton and Its Production.

Cotton is a product of the sub-tropical, tropical or warm temperate climates. It is one of the plants having filaments or threads attached to their seeds. In a cotton plant these filaments occur in bunches and in a form in which they are readily twisted together into threads, thus forming the raw material from which various textile fabrics employed in clothing are manufactured. The fibres are peculiarly fit for weaving, since they are ready for spinning without any previous chemical or mechanical preparation. This is owing to the fact that the cotton filaments are spirally curved so that when twisted they cling together and form a thread of considerable strength.

The Cotton Plant

It is shrub-like in form and grows from two to four feet in height with stalks branching extensively. The flowers are white or pale yellow, or cream colored the first day. They darken and redden on the second day and fall to the ground on the third or fourth day, leaving a tiny boll developed in the calyx. This boll develops and enlarges until maturity, when it is somewhat like a hen's egg in size and shape. In this boll are contained the seeds and lint, the products of commerce. Cotton in this country is usually planted from about the middle of March until the middle of May and matures early in the fall. These plants produce a number of cotton bolls or heads, which mature anywhere from August until the frost attacks them; it is then gathered, ginned, and compressed in bales of about 500 pounds each. In this way it is transported to the factories in various sections of the country. There are several varieties of Cotton Plants, but the two main ones are: The Sea Island and Upland.

The Sea Island or "long fibre" cotton is grown on the sandy islands near the southeastern coast of the United States, and is employed mainly for spool cotton and fine muslins. Cotton fibres are from ½ to 1½ inches in length. Nature provides in the seed that this annual plant may be perpetuated, and out of this seed in all directions grow a number of fibres which become the cotton lint of commerce. When the soil is in readiness the seeds are planted either by hand or by a planter which drops the seeds in continuous rows, so that there are no missing hills. When the tender cotton plants are a few inches out of the soil, choppers are sent in to thin them and cut out the weeds. The plants are left from 12 to 20 inches apart and the rows are from 3 to 5 feet apart. The cultivation requires considerable work and must be done from 3 to 5 times during the season, depending upon the nature of the land and the kind of weather.

Upland cotton is a shorter and more woody fibre, cultivated in the interior of the southern part of the United States. It forms a very large percentage of the cotton grown in the United States, the Sea Island cotton being a very small percentage.

The great portion of the cotton crop is picked by hand, mostly by negroes, who gather the crop at an average of 75c per 100 pounds. It is then stored in the barn or cotton house until ginning time.

The Cotton Gin

This is a machine for the separation of fibre or lint from the seeds. Before this machine was invented by Eli Whitney in 1792, the seeds had to be separated from the lint by hand. These machines are local concerns, sometimes run by farmers themselves or by corporations or business men in the neighborhood; in 1909 there were 26,669 cotton gin establishments in the United States. The farmer hauls the seed to the gin in an open wagon, from which the suction tubes suck up the cotton, where it is received by the carrying belts which distribute it along the saws from which the lint goes to the compress and the seed back to the wagon bed. This requires only a few minutes, so that both the fibre and the seed are soon on their way home again.

The bales of cotton are surrounded by a coarse covering, held together by iron bands. An important factor in the movement of cotton is the cotton exchange, the leading exchanges being at Liverpool, New York and New Orleans.

These exchanges facilitate the trade of buying and selling cotton and provide a means for facilitating the dealings and options of futures. The contracts for options are so called because the cotton contracted for is delivered at the option of the seller at any time during the month for which it is sold, and they are called futures because as a rule the contracts traded in are those which have a delivery of the cotton at some future period. The purchase or sale of about 100 square bales is made at a stated price, and payment is to be made at some specific future period.

Cotton Seed

Seed cotton, when gathered from the open bolls, contains about ⅓ lint and ⅔ seed. A few years ago these seeds rotted at the gin or were washed away in rivers, but it has been said that today cotton may be raised for the seed alone at a profit to the cotton grower. One ton of cotton seed will produce the following: 27 pounds of linters, which the gin failed to take from the seed; 841 pounds of hulls, used for fuel and for feed for live stock; 732 pounds of meal, and 280 pounds of crude oil.

The meal is used for fertilizing and feed purposes, being rich in protein, and especially popular as a feed for beef and dairy cattle. It is injurious to pigs. It contains more nitrogeneous material than any other vegetable product grown.

The crude cotton seed oil, when pressed from the seed, is then refined, the refined oil being known as "summer yellow" and sometimes as "butter oil." It is generally used in the manufacture of oleo and butterine, and sometimes used as an adulterant to butter itself. This yellow butter, when subjected to cold, becomes a product known as "salad oil," which is used for cooking, dressing and other purposes. It is extensively mixed with olive oil, and it is said that the greater part of the so-called olive oil used in this country is composed of high-grade "summer yellow." This indicates the value and popularity of the cotton seed.

The Manufacture of Cotton Goods.

Cotton was first spun by hand by the use of distaff and spindle. At first these were held in the hands; afterward they were used in connection with the revolving wheel. James Hargreaves of England invented the spinning jenny, by means of which several spindles could be operated simultaneously but a later invention was a machine that could be used in factories which made possible a great increase in the production of cotton yarns, and this industry with that of the weaver, especially after the invention of the power loom, gave birth to the modern factory in which all the different operations necessary for making cotton cloth, muslins, calico and cambric were carried on.

Spinning

It is the art of twisting fibrous substances, such as cotton, into strands or yarn fitted for weaving or for thread or rope making. To form such strands, two operations are quantities of fibre in a continuous manner, and (2) Twisting material so drawn out to give it coherency and strong-resisting powers.

The spinning frees the fibres of extraneous matter, and lays them side by side in level, parallel order, and pulls them out in a continuous strand of uniform thickness, thus attenuating the strand or sliver to the quantity required to form the yarns desired. During the process a strong current of air blows the dust and dirt out of the cotton. As the fibre goes through the machine two cylinders revolve at high speed, whose surfaces are studded with many teeth; these teeth seize the separate flocks of fibre and carry them around to form a broad, uniform teazed mass, which is called a "lap." It successively goes through several processes until the yarn is completely spun and the strand wound around the cops or cones.

Weaving

Is the art of forming a web or cloth by the intersecting of two distinct sets of fibres, threads or yarns. The one set of yarns, which pass in a longitudinal direction from end to end of the web is called the "warp"; the yarn which crosses and intersects the warp is called the "weft." In the simplest operation, it is necessary to pass one set of threads transversely through another set, divided into two series, working alternately up and down, so as to receive the transverse threads in passing and interlocking them, forming thereby a united surface of the threads.

The warp thread is divided into two equal sets by raising up every alternate one, and inserting between them a smooth rod of wood. This separation takes place before the final fixing of the ends of the threads to the cloth-beam, because, previous to that, each thread must be passed through a small eye or mail in a perpendicular thread called the heald. There are always two sets of healds in the simplest form of loom, and the threads of the warp are divided alternately by the mails of each heald, so that if one head is raised it lifts every alternate thread of the warp, and if the other is depressed it pulls down the opposite set; the united action opens a space between the two sets of warp-threads and through it is thrown the shuttle which carries the weft; when the weft has passed through, the healds are reversed, and the lower warp-threads now become the upper ones.

At each side is a shuttle box, in either of which the shuttle rests when the loom is not in operation. The shuttle is usually made of boxwood, its ends shod with iron. It contains the bobbin, on which the yarn or thread is wound, the end of the yarn passing through a hole in the side of the shuttle. Between each shed the shuttle is projected along the shutttle-race between the shed-warp from shuttle box to shuttle, and the beating up of the thread left by the shuttle completes one pick of the loom. When colored patterns are being produced, a number of shuttles corresponding to the varieties of weft must be used, and a compound shuttle box containing as many compartments as there are kinds of wefts is required.

Power Loom

The ordinary hand loom, while fully exemplifying all the principles of weaving, is now, for nearly all purposes, susperseded in most mills by the power loom. Automatic weaving was substantially the invention of the Reverend Edmund Cartwright.

By degrees various adaptations and accessories were added to the loom, which enormously increased its efficiency, until it attained that switness and certainty of action, and that power of producing all variety and quality of work, which now characterize it, and go to make it the most marvelous of all mechanical combinations. The whole of the complicated series of motions is invariably derived through the crank-shaft which revolves under the web.

Loom Mounting

This embraces a number of necessary preliminary operations, and includes in the case of warps, the warping, sizing, beaming, healding and sleying of the yarn. Warping consists in bringing together and arranging in parallel order the threads required for the breadth of web to be formed. Sizing or dressing consists in treating the threads with a glutinous or pasty compound to give them increased compactness and tenacity. Beaming is spreading the warp uniformly over the warp-beam, and rolling it around the beam in a regular manner. Healding or drawing-in is the act of drawing the warp threads through the mails or loops in the heald-shaft. After being drafted through the healds, or heddles, the warp is passed between the splits or dents of the reed, carried over the breast beam, and the ends attached to the piece-beam, and the operation of weaving may be begun.

Weaves

With two shafts of healds in the loom it is possible only to produce a plain web, and no variation of pattern can arise except from the introduction of stripes by the use of colored warps or of checks by using also different colored wefts. With three shafts a simple twill can be produced, in which the weft flushes or passes over one end and under two warp-threads alternately, thereby producing a kind of diagonal furrow, which runs from edge to edge of the cloth. With four shafts many combinations, regular and irregular, may be formed, the simplest and most common of which is known as the cassimere twill, in which two weft-threads flush over and under two warp-threads alternately in a diagonal direction.

Cotton Waste and Flocks

Cotton mill waste is the by-product derived from the cotton in its various processes through the mill. Each pound of cotton before it becomes finished cloth loses on an average of about 15 per cent. in visible and invisible waste. The invisible waste is lost through a slight evaporation of moisture in the cotton during the process of manufacture. The visible waste is of two kinds, hard and soft. Hard waste, which has been made on spinning and subsequent machines, and which bears a slight twist, and soft waste, which includes that part of the fibre rejected by all machines up to the spinning frame (sand not considered, as it is no value).

Hard waste may be re-worked by having the cotton torn up and the twist taken out by a machine. It is largely used also for wiping machinery.

Cotton waste is made into a number of products. As a filling for cotton blankets, flannels, cheap trousers, carpets, and towels it is utilized, and as both warp and filling in the making of sacks, dish-rags, scrub-cloths, wadding, jewelry packing, etc.

Flocks are short fibres removed from cloth during the process of finishing, known as napping.

EXHIBIT A.

Cotton Account (Based on Average Cost Price)

Showing quantity and cost of Raw Cotton Purchased and Used during Three Months ended March 31, 1912.

Dr.	Pounds	Value	Average Cost per pound
Purchases during period, net...........	703,127	$79,219.20	$0.112667
(Shortage of 2,714 pounds deducted)			
Cr.			
Less inventory, March 31, 1912.........	101,707	11,459.02	0.112667
Balance, Cotton put into process during period	601,420	$67,760.18	$0.112667
Deduct:			
Output or Production of finished cloth during period............	366,420	41,283.44	0.112667
Amount of stock in process.........	235,000		
Less: Inventory of stock reported in process on March 31, 1912...	165,545	18,651.53	0.112667
Shortage, waste, visible and invisible...	69,455	$ 7,825.21	$0.112667

Note.—Refer to Exhibit D, Summarized Statement of Costs, for distribution of waste over finished cloth and goods in process.

Summary of Poundage.

Cotton put into process.....................		601,420 pounds
Production of cloth	366,420	
Inventory still in process	165,545	531,965 pounds
Shrinkage in process		69,455 pounds

(Loss by shrinkage, $7,825.21)

EXHIBIT B.

Manufacturing Account.

For Three Months Ended March 31, 1912.

Stock consumed in manufacturing (601,-420 lbs. at .112667), being total cotton put into process (including waste of 69,455 lbs. or $7,825,21), per Exhibit A			$67,760.18
Direct Labor Costs:			
Superintendence ....$	600.00		
Opening, picking, carding............	5,100.10		
Spinning and spooling...............	7,810.16		
Weaving—day work	3,010.20		
Weaving—piece work	10,416.20		
Finishing	1,869.74		
Cloth room labor....................	765.00		
		$29,571.40	
Other Manufacturing Costs:			
Mill supplies used...................$	6,711.20		
Yard and watch......................	512.19		
Fuel used	1,407.95		
Wages, engineer and firemen..........	415.50		
Power purchased	920,90		
		9,967.74	
Maintenance Charges:			
Building repairs ....$	196.20		
Machinery repairs	17.20		
Depreciation expense	6,000.00		
Insurance	420.20		
Taxes	710.20		
		7,343.80	
Total manufacturing charges........		$46,882.94	
Less:			
Income from sales of waste, bagging and ties	$ 1,419.20		
Inventory of above on hand..........	214.60	1,633.80	45,249.14
Total Production Cost of finished cloth and work in process.................			113,009.32
Deduct:			
Inventory of Cotton in process, 165,545 lbs. at .177744......................			29,424.63
Balance, Cost of finished cost.......			$83,584.69

Summary of Cost.

Total pounds cloth produced............	366,420
Cost per pound of cloth.................	.228111 cents

EXHIBIT C.

Distribution of Manufacturing Charges.

Between Finished Cloth and Cotton in Process.

Manufacturing charges to be divided as per Manufacturing Account, Exhibit B	$45,249.14

The finished cloth is clear through process. The cotton in process is half way through. Apportionment of charges must then be 2 to 1 per unit of each; that is

Cloth production, 366,420 × 2 =	732,840
Cotton in process, 165,545 × 1 =	165,545
Total apportioning product	898,385

Then the cost per pound of manufacturing is:

Cloth production, $\frac{732{,}840}{898{,}385} \times 45{,}249.14$ or 36,911.10

Cotton in process, $\frac{165{,}545}{898{,}385} \times 45{,}249.14$ or 8,338.04

Note.—It is assumed that the stock in process is half way through, or will average thus, since we are told that there is no undue accumulation of stock at any stage of the work.

Distribution Rate, per pound:

Cloth— $36,911.10 div. by 366,420 equals .100734 per lb.
Process—$8,338.04 div. by 165,545 equals .050367 per lb.

EXHIBIT D.

Summarized Statement of Costs.

For Three Months Ended March 31, 1912.		Pounds	Value
Raw cotton poundage consumed		601,420	$67,760.18
Less cotton in process	165,545		
Less production poundage	366,420	531,965	59,934.97
Waste, visible and invisible		69,455	7,825.21

Cost of cotton in finished cloth	$ 41,283.44
Cost of cotton still in process	18,651,53
Cost of waste, visible and invisible	7,825.21
Total cost of cotton used	$ 67,760.18
Manufacturing costs amount to	45,249.14
Total production costs	$113,009.32

Poundage finished of cloth and of cotton still in process on which to base average costs is 531,965 pounds:

Average cost of cotton per pound of cotton put in process ($59,934.97 div. by 531,965 lbs.)	.112667
Represented value of waste per pound (cost of waste $7,825.21 div. by 531,965)	.014710
Average cost of cotton in the average pound of product and cotton in process, being 366,420 lbs. cloth and 165,545 lbs. in process ($67,760.18 div. by 531,965)	.127377
Manufacturing expenses per pound of finshed cloth ($36,911.10 div. by 366,420 lbs.)	.100734
Total cost of finished product, per pound	.228111

Cotton in Process.

Average cost per pound of cotton in process	.112667
Represented value of waste per pound	.014710
Manufacturing expenses per pound, per Exhibit C ($8,388.04 div. by 165,545)	.050367
Cost per pound of cotton in proces	.177744

EXHIBIT E.

Trading Account.

For Three Months Ended March 31, 1912.

Sales of Cloth (309,830 lbs. at .317352)			$98,325.28
Deductions:			
Cost of Cloth Production	$83,584.69		
Less:			
Finished product on hand, March 31, 1912 56,590 lbs. at .228111)	12,908.80		
Production cost of cloth sold		$70,675.89	
Selling Expenses:			
Prepaid freight on sales	$ 1,605.50		
Commissions on sales	4,737.68		
Discounts on sales	1,966.56	8,309.74	
Total Selling Costs			78,985.63
Gross Trading Profit			$19,339.65

Summary.

Average sale price of cloth per pound	.317352
Less selling expenses per pound	.026820
Net income from sales per pound	.290532
Less cost of sales per pound	.228111
Gross Profit on sales per pound	.062421

EXHIBIT F.
Profit and Loss Account.
For Three Months Ended March 31, 1912.

Credits.		
Gross Trading Profits	$19,339.65	
Tenements rents	760.90	
Total Credits		$20,100.55
Debits.		
Salaries of officers	$ 1,800.00	
Office salaries	600.00	
Stationery and office supplies	320.25	
Telephone and telegraph	60.20	
Interest	1,285.40	
Tenement repairs	44.90	
Loss on cotton futures	3,100.00	7,210.75
Net Profit for Period		$12,889.80

EXHIBIT G.
Balance Sheet, A. B. C. Cotton Mill Co.
March 31, 1912.

ASSETS.			LIABILITIES AND CAPITAL.		
Current Assets:			*Current Liabilities:*		
Accounts receivable		$ 4,300.00	Taxes accrued	$ 710.20	
Inventories:			Wages accrued	1,619.20	
Finished product	$12,908.80		Bills payable	80,000.00	
Cotton in process	29,424.63		Accounts payable	28,888.05	
Raw cotton on hand at cost	11,459.02		Total Liabilities		$111,217.45
Mill supplies	4,300.10		*Capital and Profits:*		
Waste, bagging and ties	214.60		Capital stock	$500,000.00	
Fuel	1,611.25	59,918.40	Net Profit	12,889.80	
			Co.'s Net Worth		512,889.80
Deferred Charges:					
Interest prepaid	$ 214.60				
Insurance prepaid	2,425.30	2,639.90			
Total current assets		$66,858.30			
Fixed Assets:					
Real Estate	$ 20,000.00				
Mill buildings	210,512.40				
Tenement houses	18,319.90				
Machinery and equipment	314,416.65				
Total	$563,248.95				
Less reserve for depreciation	6,000.00				
Total Fixed Assets		557,248.95			
Total		$624,107.25	Total		$624,107.25

Summary

Total Current Assets	$ 66,858.30
Total Current Liabilities	111,217.45
Balance, Working Capital	none

Comments.

This question is interesting, and it is obvious that to answer it satisfactorily, one should have some knowledge of the cotton industry and of the manufacture of cotton cloth products. For this reason extended explanations are given under the sub-title "Cotton and Its Production." The manufacturing period covered was only three months, and since there were no inventories on hand in the beginning with which to cope, matters, were therefore less complicated. We are asked for (a) Manufacturing Trading Account, and Profit and Loss Account for the period under review, and (b) a Balance Sheet at the end thereof, March 31, 1912; also for (c) a Summarized Statement of the average cost per pound of finished product. In order to arrive at the manufacturing costs and cost per pound of the finished product requires considerable figuring; and this is especially true because of the fact that there is cotton in process and no process cost given. If this cotton had been given a value, it would be very easy indeed to obtain the manufacturing cost of the finished product, but since the process cost is not given we can assume from the wording of the problem that it is one-half completed. We must therefore determine the relationship between the finished and partly finished product and then apportion the manufacturing charges accordingly. The completed cloth must bear only its equitable portion. Upon the assumption that the stock in process is half completed it is safe to charge each unit with one-half as much of the cost as would be charged to the finished unit. Therefore the distribution of costs over the finished and unfinished cotton product must be in the proportion of 2 to 1 of each unit or pound of cotton produced. We see that the production consists of 366,420 pounds of cloth and 165,545 pounds of cotton in process over which the manufacturing costs are distributed, as seen in Exhibit C. It is not assumed that this basis will result in a true distribution, but it seems to be the safest plan under the information placed at our disposal. The North Carolina examiners have done wisely in emphasizing the necessity of the study of cotton manufacturing, but since the distribution of manuafcturing costs to work in progress is not fully established it would seem advisable to state the percentage that should be added. This saves the candidate much time, labor and worry.

By referring to Exhibit A, it will be seen that the raw cotton purchased and the raw cotton on hand are both taken at the average cost price of the cotton, .112667 cents per pound. This exhibit shows also the cotton put into process, the poundage still in process, the poundage of finished cloth, and the shrinkage or waste both visible and invisible. The "visible waste" has reference to the cotton waste, bagging and ties that may be disposed of as by-products, while the "invisible waste" has reference to the shrinkage due to elimination of moisture, oil, etc. It is proper that the cost of shrinkage, which in this example amounts to $7,825.21, should be distributed as a production cost. This has been done as will be seen in the accompanying exhibits. All income from the sale of waste is required as a deduction from the manufacturing costs, but good reasons could be cited for placing this income in the profit and loss account.

We are told that the market value of cotton at the date of closing was 13c per pound, but in working the problem this is ignored since it is

poor policy to take profits before they have been earned. The cost price established is .112667 cents per pound and this has been used in inventorying the cotton on hand since it is the true average cost of raw product. To value the cotton at the market price would inflate the inventories, unduly increase the profits for this period, and result in a corresponding increase of production costs in the succeeding period. Cotton mills usually work by the periods of three months each. The average purchase price of the raw cotton is used in valuing the inventory since it is more convenient than to determine the varying cost price of the different lots of cotton bales purchased. This is particularly true when there is a large supply of cotton packed in the warehouse and some of it has been on hand for several months. So long as a careful account is kept of the number of bales and the weight of cotton placed in the warehouse, and the cotton removed therefrom, it is an easy matter to determine the poundage of cotton still therein. The value of such poundage may be taken at the average cost price. In a small mill where the cotton supply is in like proportion it might perhaps be well to ascertain the exact number and cost of the bales in stock, in which case the exact cost of the particular lot on hand could be ascertained. The average price may in some cases be lower than the cost price and in others higher, but in the whole it averages itself satisfactory; the safe rule in inventorying, however, is to take either the cost or the market price, which ever may be the lower. On the other hand, if it were not for the undesirability of anticipating profits and disarranging of manufacturing costs, there might be no objection to inventorying raw stock at the market price on the date of closing.

It will be seen that the depreciation account has a debit of $6,000.00 with a corresponding amount in the reserve for depreciation account, thus indicating that an adequate amount for the depreciation of properties is written off monthly or quarterly. The loss of $3,100 on cotton futures has been entered in the profit and loss account, but the circumstances underlying it might be such as to justify its addition to the raw cotton account and as a manufacturing charge.

The various exhibits show clearly the manner of illustrating the results of the problem, but it must be kept in mind that this solution with its accompanying explanations is more exhaustive than would be required on an examination. The time limit is too short for so much detail. There is some duplication of work in the exhibits and more details than might be justified, but this is done to provide a clearly stated lesson. The reader is referred for further information on Cotton Mill Accounting to various articles which have appeared in the Journal of Accountancy. Mr. Joel Hunter, C. P. A., of Atlanta, Ga., contributed a very excellent article on "Cotton Mill Accounts" to the issue of August, 1913, and another to the issue of December, 1912, on "Cotton Seed Oil Mills and Their Accounts." The Journal of April, 1912, contained another excellent article on "Cotton Mill Accounting" by G. G. Scott, C. P. A., of Charlotte, N. C., a member of the board of examiners in that state. Additional information can be gotten from Government Reports and Schedules, and especially from the exhaustive report on Cotton Manufacturing presented to Congress in 1912 by the Tariff Board on Schedule I of the Tariff Law.

PART THREE

Auditing

COMPLETE SET OF AUDITING QUESTIONS FROM MINNESOTA EXAMINATION, 1912.

1. State the purposes of an audit. To what extent should an audit deal with accounting system? With bookkeeping system?
2. Distinguish between the "continuous" and the "completed" audit, stating the advantages and disadvantages of each.
3. Describe the method of verifying cash on hand at the close of the period under review.
4. Discuss "the best method of auditing cash receipts."
5. Discuss "the best method of auditing cash payments."
6. How would you audit a payroll?
7. What special matters should be investigated in the audit of corporate books?
8. What different considerations govern the valuation for balance sheet purposes of "fixed" and "current" assets?
9. What is the best procedure in verifying the existence and value of land, buildings, stock-in-trade, investments in stocks and bonds, plant and machinery, work-in-progress?
10. Discuss "the proper method of treating discounts, freight and haulage on goods or equipment purchased." On goods sold.
11. Discuss "the limitations of an investigation of a business on behalf of a projected purchasing company." To what extent would fraud by employes of the vendor bear upon the subject?
12. In what respect would an investigation of a business on behalf of a retiring or deceased partner differ from one on behalf of a projected purchasing company?
13. Discuss "the extent of the auditor's certification."
14. Discuss "the proper method of presenting the condition and earnings of a holding company which owns from 75 to 100 per cent of the stock of a number of subsidiary corporations."
15. State the special features which pertain to the audit of the books and accounts of a building and loan association.
16. State the special features which pertain to the audit of the books and accounts of a street railway company.
17. State the special features which pertain to the audit of the books and accounts of a fire insurance company.

18. A mercantile concern sustains a partial loss by fire. The books are modern except no cost accounting is incorporated. The end of the fiscal year is December 31, when a physical inventory is taken; the fire occurred in October and was evidently a two-thirds loss, with full insurance. While the adjusters are at work you are called in to satisfy the firm as to their loss, so that they may be prepared for discussion with the insurance companies.

Outline your procedure and state how you arrive at the actual loss.

Answer to Question 1.

An audit may be required for various reasons:

(a) As a matter of precaution to insure promptness in work, to prevent possible errors or carelessness, and to prepare certified statements for the directors.

To certify to the balance sheet and to the financial condition as shown thereby.

To adjust careless and unskillfully kept accounts and to suggest improved methods.

To detect suspected defalcation or irregularities.

To enable certification of a financial statement for presentation to bankers to secure loans.

To enlighten a prospective purchaser as to condition and earnings.

To determine gross cost, net profit or averages as may be desired.

It may be at the instance of the president or other officer of a company, or of the directors or the stockholders, or of a partner in the case of a partnership, or of the creditors of the court, or by a prospective purchaser.

Audits are frequently provided for in the corporation's by-laws. In Canada the laws require that annual audits be made.

The books and accounts of churches, clubs and other organizations are also subject to audit for similar reasons.

(b) The scope and extent of the audit requested will largely determine how far it will deal with the accounting or bookkeeping system. If by accounting is implied the caption and allocation of accounts in the balance sheets and subsidiary statements, this will probably necessitate such arrangements of facts and figures as would seem to the auditor most clear and logical to the persons for whom they are prepared, and he would suggest such changes as would be appropriate; and if by bookkeeping is meant merely the books, general and subsidiary, a competent auditor would naturally suggest such changes as would simplify or amplify the results to the improvement of the system in use. As a rule, however, the auditor in conducting an audit is not supposed to concern himself with the accounting system or methods of bookkeeping.

Answer to Question 2.

(a) A continuous audit implies the regular employment of an auditor from period to period, (say monthly), and permits the employment of less skilled bookkeepers, as their methods can be supervised and directed into

the proper channels by the auditor's supervision. A further advantage lies in the fact that comparison with the audit previously made calls attention to many features which might not be evident in a first audit. There might be a disadvantage in the probability that a continuous audit would be less thorough, as habit in most cases begets confidence, which is not always justified. It has the advantage, however, of keeping the employes up-to-date in their work and impresses them with the desirability of accuracy. A disadvantage lies perhaps in the possibility of changes being made in figures passed upon by the auditor during one of his many audits, since there is little likelihood of his going back over audited work. In that case the annual statement could contain irregularities without much chance of detection.

(b) A completed audit is more often for a specific purpose and therefore brings out more clearly that for which it is instituted as a search for a lost article will more likely result in its discovery than a general clearing up. The "completed" job means one that is finished completely at one time, usually at the end of the year. In this way everything comes under the auditor's scrutiny at one time and is completed without any possibility of changes in results or substitution of assets.

As a general toning up and control of the accounting methods the completed audit is not so effective as the continuous, as impressions and suggestions are soon forgotten unless there is in the mind of the bookkeepers the expectation that all or any of their records will again be brought under the eye of the same auditor.

Answer to Question 3.

If the Imprest system of petty cash is used, the cash and cash items should be counted, and the cash items, if any, authorized by some one in authority. The balance of the petty cash record should agree with the petty cash drawer, while the payments credited to the Treasurer must agree with the receipts which have been given to the Treasurer, and with the stubs of the Treasurer's check book or, better still, with the checks themselves.

The Treasurer's cash is in the bank and the balance should be obtained from the bank. His check book balance or bank record should be reconciled with the bank's balance by the addition of outstanding checks, and also made to agree with the balance in the cash book. Current cash not yet deposited must, of course, be closely compared.

If no separate petty cash system is in vogue, the cash and cash items must be added to the check book balance to prove with the cash book balance, the check book balance being reconciled with the bank balance as above. Bank discounts, collections, interest or charges must, of course, have been entered upon his cash book and check book to effect an agreement with the bank's balance. Of course, in order to verify the accuracy of cash, an audit of the receipts and payments should be made and this would involve an examination of discounts deducted from Dr. payments to see if they were approximately correct. Also the examination of vouchers for all payments and in any case where these are not produced the entries should be investigated until their validity was clearly established.

Answer to Question 4.

In auditing receipts we must determine whether all receipts have been accounted for, and, if so, what has been done with them. Theoretically, at least, the best system of keeping cash receipts which includes currency, checks, bank drafts, money orders, etc., is to deposit the total of all receipts each day in the bank and to make all payments by means of checks. The bank's record of deposits in this way keeps a tally on the cash receipts day by day and renders an audit both easy and rapid. If only a part of the receipts are deposited each day and the remainder retained for the payment of petty expenses or other obligations, then the bank balance and not the deposits is used and this bank balance added to the current cash undeposited will verify the total cash balance as shown by the books. Of course, as in all systems, difficulties will creep in. Thus A may be at once an Account Receivable for $100 and an Account Payable for $50 and may remit the difference, in which case the usual and most convenient way would be to credit A in the receipts with the $100 and to charge him in the payments with $50, which will, however, make the receipts $50 more than the deposits recorded by the bank. To avoid this it would be necessary to transfer the Account Payable account to the Account Receivable, which might be undesirable as for statistical purposes they are better kept apart. Where possible, statements of their accounts should be mailed to customers by the auditor and the balances approved by them, and if by their protests it should appear that receipts have been held out or held over, the deposit tickets should be obtained from the bank and the items compared with the cash book entries to ascertain if the checks have been deposited on the day received.

Answer to Question 5.

If all receipts are deposited, all payments must be made by checks and the payments may be verified by the cancelled checks and by comparison with the Accounts Payable balances, while the invoices thus credited should be examined to see that they have been properly vouched and entered.

When all receipts are not deposited all payments except very small amounts (of which memorandums should be filed) should be covered by voucher, and where vouchers are not found such payments should be investigated. The cash book additions should always be checked and the carried forward figures examined. Void checks should be cancelled and should remain attached to the stubs.

Answer to Question 6.

No bookkeeper or cashier should make payments of any kind without authorization, general or specific, and should have receipts or vouchers covering all disbursements.

This is equally true of pay roll (wages or salaries) whether receipts are taken upon payment or not. The voucher in this case is the time slip or pay slip from the foreman or time clerk.

The auditor should submit to the foreman or manager the pay rolls paid on several occasions in order that they may detect any names or amounts which should be investigated, and several of the time slips taken

at random should be scrutinized to see if the extensions are correct; the pay roll footings should be checked and the totals compared with the entries in the cash book.

In a cost system the total wages of given periods should be compared with the total wages allocated on the various cost sheets, to which must be added the unproductive labor apportioned to various accounts by the bookkeeper, and it is this unproductive labor which should be more carefully considered.

Answer to Question 7.

By corporate books is taken to mean the books of record, consisting of the Stock Ledger, the Certificate Book and the Transfer Book, by-laws and minutes of meetings, etc. These should be examined to see that the official acts have not exceeded the authority stipulated in the Charter and by-laws.

It must be noted that the stock issued and outstanding agrees with the original authorization, as recorded in the general books; also that dividends have been declared out of earnings and paid to the rightful owners of shares.

Answer to Question 8.

The fixed assets of one business may be the current assets of another and vice versa. Thus horses, although they are never still, are generally considered as fixed assets; but in the case of a horse dealer they are his stock in trade and come under the heading of current assets.

Fixed assets refer to capital investment useful or necessary to the conduct of the business or productive of revenue, and the considerations as to their valuation in the balance sheet consists of:

Their cost, whether purchased, manufactured or otherwise acquired;

Their selling value at forced sale, in the regular course of events, or under special conditions;

Their fire value, which would be the cost of replacement in their present depreciated condition;

Their replacement value, which might be more than their fire value, as their loss might necessitate new and more expensive equipment;

Their offset value, by which is meant the book value, less the mortgage, reserve or the deductable credit account;

Their depreciated value, by which the account has been written down or a reserve created, and whether too much or too little depreciation has been allowed;

Their book value, by which a secret reserve may be maintained or which, for other private or personal reasons, a stated amount is recorded.

Current assets represent the working funds and realizable assets of a concern including cash, accounts receivable, stock in trade, etc., and the consideration as to their valuation in the balance sheet are as follows:

Their cost, whether purchased, manufactured or acquired;

Their selling value under ordinary conditions;

Their depreciated value;

Obsolescence of stock in trade;

Their appraised value, and by whom they have been appraised;

Cash is the most liquid and unchangeable in value of all assets;

The probable proportion of uncollectable accounts must be considered in accounts receivable.

Assets which are controlled or held by bankers or others to secure the payment of obligations must be so noted as they are not available for the general creditors or stockholders.

Answer to Question 9.

It is not enough to see the land and the buildings and to assume that the ownership is complete. The deeds should be examined and the county records searched for a verification of title. This examination will disclose encumbrances if any exist.

Tax receipts should be examined.

The inventory of stock in trade, if accepted from written records, should be gone over carefully and the computations and footings proved and the persons in authority who took or certified to the inventory should be noted in the report. Care should be exercised to see that goods not invoiced are omitted and that goods delivered have been deducted, that the values are taken at cost and not at selling prices, and that the overhead charges on the unsold goods do not include administration or selling expense.

Certificates of stocks, bonds, etc., should be carefully examined, or if they have been turned over to the bankers as collateral for loans, the bank's receipts therefor should be examined. Coupon bonds must have all undue coupons attached, and interest may, if desired, be taken as an asset.

Plant and machinery often include good will (which is really a separate asset), and its valuation is hard to accurately determine. In some cases additions to plant are charged off to production and the plant maintained in its full efficiency and no depreciation written off. In others, the additions are capitalized and a systematic depreciation is allowed, the latter method having the more general approval.

Work in progress should be taken at its cost in labor and material, plus direct factory expenses and the correct proportion of overhead charges. If a cost sytem is installed the cost sheets provide this information, otherwise the results will be obtained largely by estimate.

Answer to Question 10.

Discounts on goods purchased may be deducted from purchases, giving the net cost of the purchases, or they may be treated as profit derived from the prompt settlement of accounts payable, and credited to Profit and Loss. For trade discount, the former method is always preferable.

Discounts on goods sold may be deducted from sales, giving the net sales, or may be treated as a charge against profits to induce prompt settlements, some favoring one method and some the other. If small, a good practice is to charge to Profit and Loss. Freight and haulage inward is part of the gross cost of materials purchased, while freight and haulage outward (if not charged to the customers) is a delivery or selling expense to be charged against the gross trading profit.

Freight and haulage on equipment purchased may properly be capitalized (added to the cost) as it is a part of the cost of installation.

Answer to Question 11.

An investigation on the part of a projected purchasing company would be largely limited by the demands of the selling company. The bookkeeping or accounting methods would not be under examination so much as the net realizable value of the available assets less the obligations and liabilities. Their worth as a going concern and their relation to the average profits during past years and the amount of good will with which the proposed purchaser is to be charged. The aggregate and average profits for a term of four or five years should be considered and fully verified. Fraud on the part of employes of the vendor before the deal was consummated would no doubt warrant the purchaser in voiding the agreement or in making a deduction from the payment, whereas if the settlements were completed probably he would have to recover his loss through the courts. Innocence on the part of the vendor would not relieve him from the responsibility for the acts of his agents or employes.

Answer to Question 12.

In the case of deceased partner the business must be closed and the profits divided according to the terms of partnership. The accountant must determine whether the retiring or deceased partner's account is correct by a detailed audit. The remaining partner may continue alone or buy out the interest from his partner's estate, whereas in selling a business to another it is the ownership of the business which is sold, irrespective of the amount of the profits on hand, and there need be no cessation of business or settlement of its affairs to that date. An investigation in the former case would aim, therefore, to determine the exact value of the deceased partner's interest in the business at his demise, whereas in the latter case the value of the going concern and the probable future profit will form the basis and chief object of the investigation.

Suggested steps in an investigation for a retiring partner:

An audit of the accounts for the current year, and perhaps for two or three years.

Make the necessary adjustments, if any.

Prove the accuracy of the sales account for the period under review.

Determine the accuracy of the gross profits for the same period.

Analyze the net profits and determine their accuracy.

Adjust the capital account after all changes have been made.

Show adjusted Trading and Profit and Loss account for past year, if necessary.

Adjust balance sheet for former year, if necessary.

Make Trading and Profit and Loss account for the current year to date of dissolution.

Make balance sheet for the current year.

Answer to Question 13.

The Auditor's Certificate is a certification of the results of the audit as set forth in the statements to which it is attached. The extent of the certificate depends upon the scope of the audit, and anything short of a

complete audit should be qualified in the certificate, as the auditor should not certify to anything which has not come specifically under his inspection. Suggestions for improvement in the system or management may be incorporated in his report, if one is made, or else verbally. If important adjustments have been made or suggested by the auditor, they should be in the report, while if desired for publication or for presentation to bankers for credit, a short form of certificate may be appended to the report. The following form of certificate may be used:

Philadelphia, January 4, 1914.

I have examined the books and accounts of the A B C Company and I hereby certify that they are correct and in accordance with the balance sheet as presented above, and that the profits are as stated therein.

J. L. BROWN,
Auditor.

This is usually attached to the balance sheet and profit and loss statement. It should be borne in mind, however, that a report and a certificate are two different things. The report is a more extended review of the company's affairs with the auditor's findings.

Answer to Question 14.

A holding company is not the owner of the assets of the subsidiary companies which it may operate, and whose stock it controls, nor is it liable for their obligations except as a stockholder. The assets of the holding company are the shares of stock owned, and its source of profit consists of dividends declared by the underlying companies.

The holding company may be organized by the major interests of the subsidiary companies; for example, the company is incorporated with a capital of $1,000,000. The entire stock is taken by the incorporators in exchange for $100,000 in cash and $900,000 of stock in companies which they represent. The underlying companies retain their legal status, but their control passes to the holding company.

Sometimes it is formed on a cash basis, and the stocks are purchased at a figure much below par, in which case the stocks are entered at par and credited to cash and surplus, or else charged to Investment at the cost price.

The earnings of the holding company are, as above stated, the dividends from the subsidiary companies, against which are charged the administration and other expenses, the balance being the net profit of the said company. Borrowings from or loans to the controlled companies are treated on the books of the holding company as they would be in the case of independent companies. The reports of the several companies may be appended to the holding company's report, but are independent of it. Sometimes, however, as suggested in the question, when the underlying companies are fully controlled the condition and earnings of all are consolidated in one balance sheet and one statement of earnings.

Answer to Question 15.

In the books of a building and loan association a General Ledger is not always kept, but it is better to do so, in which case it would contain the following accounts:

Stock Loans,
Real Estate Loans,
Investments,
Cash,
Real Estate,
Furniture and Fixtures,
Dues,
Dues in Arrears,
Interest in Arrears,
Notes Payable,
Surplus or Fund for Contingent Losses,
Profits (undivided),
Income and Expenses,
Expense,
Interest Credit,
Interest Debit,
Salaries,
Advertising,
Rent,
Attorney Fees,
Fines,
Premiums,
Entrance and Transfer Fees.

The Income Account into which the Income and Expenses are closed at the end of the fiscal year is the summary account, and the balance of this account, being the net profits for the year or period, is transferred to the Profits account. This account is charged with the profits taken by withdrawing members, or completed series, but is never closed, as the profits added from time to time are never completely exhausted by withdrawals, as withdrawals do not take with them their full shares of accumulated profits, the balance belonging to the unmatured series. Other books, papers, etc., are as follows:

Members' Ledger or Roll Books.
Loan Register,
Cash Book (columnized),
Blotter,
Treasurer's Cash Book,
Receipt Book,
Journal,
Order Book,
Application for Loan,
Application for Withdrawal,
Transfer of Collateral for Loan,
By-Laws and Minutes,
Check Book.

A careful inspection and comparison of at least the principal books and accounts should be made, the by-laws should be studied and the minutes read. The cash on hand and in bank should be verified and the receipts therefor from the Treasurer to the Secretary. Stock and real estate loans should be verified and all entries relating thereto carefully compared. All deeds, mortgages and collateral should be on hand and available, an evidence that the taxes and insurance is paid on the properties, should be required. This method of apportioning profits and its application should be looked into and the bonds of officers examined, and it should be determined that the published statements are correct and in harmony with the books. This is important.

Answer to Question 16.

A Street Railway Company is a public service corporation and in many states it must conform its accounts to the requirements of the Public Service Commission of the state in which it operates. The capital assets and equipment must be shown at their cost of acquisition, extensions and improvements being shown separately. Depreciation on plant and equipment should be based on the estimated life of the property. This matter is usually laid down in the rules of Public Service Commissions. Maintenance and other expenses must also be charged according to their rulings. Interest on bonded debt and fixed charges must not be confused with maintenance or administration expenses. With large companies it is often the case that many of the lines are leased, while the improvements and extensions to them are owned by the parent company. Pleasure parks are often operated at a loss, which is made up by the increased travel on the road. Statements showing the cost per mile, the cost per passenger, the cost of free transfers and the proper division of such costs, the partial capitalization of strike losses, the division of cost of bridges with the railroads and municipalities, paving and other improvements, and the inter-company loans and passing of collateral are features which should have the careful attention of the auditor. A careful audit must be made of the balance sheet and statement of earnings.

Answer to Question 17.

The auditor of a Fire Insurance Company can only certify to a complete audit after examination and comparison of almost all the accounts and records of the company, which would include:

Daily reports of risks written and of alterations and additions thereto.

Premium registers, in which the premiums are charged to the agent or to the insured direct.

The accounts with the agents and the balance due.

Income from rents, investments and other sources.

Bonds and other securities in its possession or in the hands of Trustees.

The commission and agents' expense account.

The check book, cash and bank accounts.

Unearned premiums and delinquent premiums.

Loans and bills receivable.
Unpaid and disputed losses.
Capital, reserve and surplus.

The important consideration in an audit is that the premiums received during the year are not all income for the period, as the risks are written for one, three and five-year terms, and from them must be deducted the cost of amounts reinsured and the unearned premiums on the policies which extend beyond the period. Other sources of income are rents, interest, dividends, etc., while the expenses are composed of losses by fire, agents and other commissions, maps, salaries and other expenses.

The auditor must see that the reserves are calculated according to the rules of, and are sufficient to meet, the requirements of the Insurance Department, to which it must report, and that such reports are in accordance with the facts and in harmony with the records. The auditor should also see that risks are entered upon the underwriter's maps, summarizing the peculiar features of fire insurance auditing to which the auditor should give attention, including the accounts with agents, fire losses, unearned premiums and investments.

Answer to Question 18.

It is evident that the loss is equal to the value of entire stock on hand at the time of their fire, less the value of the stock unhurt or partly damaged which remains, and the two essential points therefore are the original value of the stock and its present value. The books of this concern being modern, there is a recorded inventory of the stock on hand January 1, to which must be added all purchases, January to October, freight and cartage inward, duties, royalties and other charges which contribute to the gross cost of the goods, and from this total must be taken the goods sold and delivered to the date of the fire, at cost, which can only be determined, where no cost system is kept, by deducting the average percentage of profit for past years from the selling price. This is not necessarily accurate, but the best that could be done under the circumstances. The result obtained is the cost value of goods on hand before the fire.

The value of the goods after the fire may be largely obtained by the stock numbers and reference to the invoices, while the damage sustained will be a matter of opinion and appraisement which will have to be adjusted, but the insured will put his own valuation on them in putting in his loss claim. It is stated that the loss was a two-thirds loss with full insurance. If it were known that the loss were exactly two-thirds it would only be necessary to find one of the above values and calculate the loss therefrom. Full insurance to the amount of loss would not cover the insured under the 80%, or the 90%, or the full insurance clauses, but full insurance on the value of the stock would of course protect them fully. Under the 80% clause the insured is co-insurer for the difference between the total amount of insurance he carries and 80% of the value of the property insured.

THE AUDITOR'S REPORT.

AN AUDITOR'S report should be clear and to the point, and be as brief as possible, but in this answer it is purposely made larger than the problem requires in order to show the manner of including explanations and suggestions. The exhibits shown are not presented as model forms, but for the purpose of giving information in the simplest way, and the explanations contained in the report should be sufficiently clear without additional comments.

Problem No. 1.

You are retained by the Appliance Manufacturing Company to audit its accounts for the year ending June 30, 1912, and to prepare the balance sheet, trading and profit and loss accounts for the year.

You are expected to write a brief report of not less than 200 and not more than 400 words, dealing with your audit, showing its scope, and discussing any matters relating to the accounts which may seem to you to be of interest.

The company was incorporated on July 1, 1911, and its balance sheet on the date showed as follows:

Balance Sheet July 1, 1911.

ASSETS.		LIABILITIES.	
Cash	$ 12,680.92	Bills payable	$ 10,901.07
Bills receivable	2,200.00	Book accounts payable	15,617.04
Book accounts receivable	19,501.33	Capital stock	200,000.00
Merchandise material on hand	9,554.43	Reserve for suspended accounts receivable	1,019.16
Machinery and tools	129,355.01		
Furniture in office and store	11,762.18		
Expenses of incorporation	500.00		
Book accounts receivable in suspense	1,983.40		
Good will	40,000.00		
Total	$227,537.27	Total	$227,537.27

The inventory of merchandise and material amounts to $12,453.90.

You discover the following facts not disclosed by the books:

(a) Invoices not entered.

Maryland Steel Co., dated June 15, 1912, for steel.........$165.00
York Safe and Lock Co., dated June 1, 1912, for office safe.. 110.00
Vulcan Coal Co., dated May 20, 1912, for coal........... 42.50

(b) The company made in its shop for its own use five machines, in the construction of which it used material costing $525.00, and the mechanics' wages amounted to $750.00.

The Trial Balance of June 30, 1912, was as follows:

Trial Balance.	Dr.	Cr.
Cash	$ 5,259.80	
Notes receivable	5,048.75	
Notes payable		$ 16,922.81
Sales		240,172.56
Material and supplies	52,088.94	
Sundry merchandise bought	2,869.80	
Selling wages	22,400.04	

Manufacturing wages	88,317.70	
Miscelaneous receipts		549.20
Office salaries	5,802.50	
Manufacturing expenses	15,353.16	
Office expenses	2,496.14	
General selling expenses	3,491.50	
Advertising	2,064.33	
Light, heat and power	3,121.97	
Rent of factory	4,000.00	
Rent of office and store	1,860.29	
Repairs to machinery, etc	845.78	
Delivery expenses	2,201.01	
Interest and discount	738.40	
Commissions	5,089.30	
Machinery and tools	132,817.24	
Dividend (paid January 10, 1907)	6,000.00	
Furniture, etc., in store and office	12,016.45	
Book accounts receivable	58,935.20	
Book accounts payable		18,311.16
Expenses of incorporation	500.00	
Reserve for suspended accounts	320.59	
Good will	40,000.00	
Capital Stock		200,000.00
Accounts receivable in suspense	2,316.84	
Totals	$475,955.73	$475,955.73

The Report.

To the Directors and Stockholders, Appliance Manufacturing Company, Philadelphia, Pa.

Gentlemen:—

In compliance with your instructions I have made a careful audit of the accounts of your company for the fiscal year ended June 30, 1912, and present herewith exhibits and statements which give detailed information.

It will be seen by Exhibits A and B that the year's business has been good, and that the net profits after allowing for depreciation bad debts, etc., amount to $28,421.63. This is equivalent to 14.21% on the capital stock, and about 12% on the sales. Exhibits C and D show the financial condition of your company at the present time, and a comparison of same with that of one year ago. It will be seen that there is a working capital of $182,421.63, including capital and undivided profits after deducting the good-will. There are, however, a few important points in connection with the accompanying exhibits and concerning the accounting system to which I wish to call your attention.

Subdivision of Accounts.

It is advisable that your accounts be arranged so as to show the cost of manufacturing separately from the cost of trading, so that correct statements may be made giving the exact cost chargeable to each department. This has already been partly accomplished, but further divisions are neces-

sary. The charges and costs for various purposes should be indicated so clearly that there would be no doubt as to their disposition.

The same principle is true also of general expenses, which should clearly indicate the amounts chargeable to various departments. Rent of office and store, for instance, should be subdivided, instead of being given in one amount.

Material and Merchandise.

The inventories at the end of each year should show the value of raw material on hand, at cost, the value of finished stock or merchandise at cost of production, and the value of goods in process, at cost of raw material plus accrued charges. This would permit the preparation of correct manufacturing statements showing the exact cost of producing the finished stock, and correct trading statements showing the direct cost of marketing the reference. The values placed upon inventories were submitted by your Directors.

Items Omitted.

I found invoices to the amount of $317.50 not entered on the books. Adjusting entries have been made, and they are now included in the proper accounts. Entry should be made for each invoice when received.

During the year five machines were made in your shop for your own use, in the construction of which material costing $525.00 was used and mechanics' wages amounting to $750.00. Adjusting entries have been made for these, charging Machinery Account and crediting Manufacturing Account. Production orders for factory use should be handled the same as orders for customers, and, when completed, charged to the proper account and credited to factory output.

Book Accounts Receivable.

The Accounts Receivable seem to be in keeping with the volume of business done, yet they are quite large and should be closely watched.

The plan of separating doubtful accounts from the good is commendable, and I have taken the liberty of apportioning from profits 65% of the suspended accounts as a provision against losses. This is based on the proportion of failures from suspended accounts listed at the beginning of the year.

Depreciation.

I have allowed a depreciation of 8% on machinery and tools, based on the valuation at the beginning of the year; and 6% on furniture in store and office, on the same basis. The percentages selected are to be computed on the diminishing values at the end of each year. It would seem better to separate the tools from machinery account, since they do not depreciate in the same ratio.

Incorporation Expenses.

It will be seen that I have written off $200.00 of the incorporation expenses. It would be prudent to write the remaining $300.00 off at the end of the coming year.

In conclusion I wish to express to the officers and bookkeepers my sincere appreciation of the courtesies extended during the course of the audit. Respectfully submitted,

R. J. BENNETT, C. P. A.

EXHIBIT A.

Manufacturing and Trading Statement, June 30, 1912.

Debits to Manufacturing.

Inventories, July 1, 1911	$ 9,554.43	
Purchases material and supplies	42,699.51	
Wages paid	88,317.70	
Manufacturing expenses	15,353.16	
Light, heat and power	3,164.47	
Rent of factory	4,000.00	
Repairs to machinery	845.78	
Depreciation of machinery	10,348.40	
Total manufacturing charges		$174,283.45

Debits to Trading.

Merchandise purchased	$ 2,869.80	
Selling wages	22,400.04	
Selling expenses	3,491.50	
Advertising	2,064.33	
Rent of store—estimated	1,500.29	
Delivery expenses	2,201.01	
Commissions allowed	5,089.30	
Total trading charges		39,616.27
Total manufacturing and trading charges		$213,899.72
Less material and merchandise on hand		12,453.90
Cost of goods sold		$201,445.82
Summary:—		
Sales for year	$240,172.56	
Other income	549.20	
Machines for shop use, at cost	1,275.00	
Total sales and machines made for own use		241,996.76
Total cost of sales		201,445.82
Gross Profit for year		$ 40,550.94

EXHIBIT B.

Profit and Loss Statement.

Credits.

Gross Profit from Trading		$40,550.94

General Expenses.

Office Salaries	$ 5,802.50	
Office Expenses	2,496.14	
Interest and Discount	738.40	
Rent of Office	360.00	
Incorporation Expenses	200.00	

Reserve for above 7-1-06	1,019.16		
Suspended Accounts Written Off	$1,339.75		
Excess of Losses over Reserve		320.59	
Reserve for Suspended Accounts, 65%		1,505.95	
Depreciation on Furniture and Fixtures, 6%		705.73	
Total Expenses for year			$12,129.31
Net Profit for year			$28,421.63
Summary:—			
Net Profit for year		$28,421.63	
Dividends paid 1-10-07		6,000.00	
Profits undivided		$22,421.63	

EXHIBIT C.

Balance Sheet.

ASSETS.

Cash on hand	$. .5,259.80	
Notes receivable	5,048.75	
Accounts receivable	58,935.20	
Accounts receivable in suspense	2,316.84	
Merchandise and material on hand	12,453.90	
Machinery and tools on hand	134,092.24	
Furniture and Fixtures	12,126.45	
Incorporation expenses	300.00	
Good will	40,000.00	
Total Assets		$270,533.18

LIABILITIES.

Notes payable	$16,922.81		
Accounts payable	18,628.66		
Total Current Liabilities		$ 35,551.47	
Reserve Accounts:—			
For depreciation on machinery and tools	$10,348.40		
For depreciation on furniture	705.73		
For suspended accounts receivable	1,505.95		
		12,560.08	
Capital Stock		200,000.00	
Undivided Profits:—			
Net profits for year	$28,421.63		
Less dividends paid 1-10-07	6,000.00		
Balance, profits undivided		22,421.63	
Total Liabilities			$270,533.18

Note.—Excess of actual assets over actual liabilities, $182,421.63.

EXHIBIT D.

Comparative Statement of Assets and Liabilities.

ASSETS	June 30, 1911	June 30, 1912	Increase	Decrease
Cash	$ 12,680.92	$ 5,259.80		$ 7,421.12
Notes receivable	2,200.00	5 048.75	2,848.75	
Accounts receivable	19,501.33	58,935.20	39,433.87	
Accounts receivable in suspense	1,983.40	2,316.84	333.44	
Mdse. and Material	9,554.43	12,453.90	2,899.47	
Machinery and Tools	129,355.01	134,092.24	4,737.23	
Furniture and fixtures	11,762.18	12,126.45	364.27	
Incorporation Expenses	500.00	300.00		200.00
Good will	40,000.00	40,000.00		
Total Assets	$ 227,537.27	$ 270,533.18	$ 42,995.91	
LIABILITIES				
Notes payable	$ 10,901.07	$ 16,922.81		$ 6,021.74
Accounts payable	15,617.04	18,628,66		3,011.62
Current Liabilities	26,518.11	35,551.47		
Reserve Accounts:–				
For depreciation		11,054.13		11,054.13
For Suspended Accts	1,019.16	1,505.95		486.79
Capital Stock	200,000.00	200,000.00		
Total Liabilities	227,537.27	248,111.55		20,574.28
Undivided Profits		22,421.63	(Increase)	22,421.63
	$227,537.27	$ 270,533.18	$ 42,995.91	$ 42,995.91

Problem No. 2. NY 1912

The following is a comparative balance sheet at December 31, 1910, and at December 31, 1911, presented to the Board of Directors of the Western Company at their meeting of January 5, 1912:

Assets.

	1910 12/31	1911 12/31
*Land	$20,000	$25,000
Buildings	45,000	45,000
Machinery and tools	86,000	89,000
Horses, wagons and harnesses	10,500	10,500
Patents	6,000	6,000
Good-will	25,000	25,000
Cash	28,300	10,300
Accounts receivable	29,600	26,550
Investments and bonds	.....	15,000
Inventory of goods in process	10,800	14,690
Inventory of materials and supplies	6,750	10,300
Agency investments	.....	3,680
	$267,950	$281,020

Liabilities.

	1910 12/31	1911 12/31
Bond and mortgage payable 1915	......	$ 20,000
Notes payable	$ 35,000	2,000
Accounts payable	16,400	19,350
Reserves for depreciation	2,500	6,750
Discounts on bonds	......	1,000
Capital Stock—		
Preferred	150,000	150,000
Common	50,000	50,000
Surplus	14,050	31,920
	$267,950	$281,020

* Land increase due to appraisal based on rise of values of factory sites in the immediate vicinity.

Together with the above balance sheet, there was submitted to the Board a statement of income and profit and loss showing the profits of the year 1911 to have been $22,120. The directors state to the auditor that in view of the decrease of cash and accounts receivable, of the absence of dividends and of the increase of capital liabilities, they are unable to ascertain what has become of the increased profits of the year. The auditor prepares and submits to the directors before the meeting is adjourned an account properly named, which is so arranged as to show clearly how the Western Company has applied such resources of the year 1910 as have been lost in 1911, and the resources and profits of the year 1911.

Prepare the account submitted by the auditor.

Comments.

This question is one (the easiest) of three given in a recent C. P. A. examination in New York. Two of the questions were to be answered, and since only three hours were allowed it will be seen that this one was required to be completed in less than ninety minutes. The time limit is not at all unreasonable, because any candidate who is qualified to practice as an accountant should be able to complete it easily within the specified time. Indeed, candidates for accountancy honors should always time themselves when answering problems and questions that have been used by examining boards, in order to accustom themselves to rapid work and to the preparation of solutions within reasonable time limits. This plan should be practiced and adhered to until the required work can be done within the limit of time selected.

In the problem under review the comparative balance sheet and profit and loss statement were submitted to the board of directors and rejected by them as incomplete and unintelligible. The auditor therefore is required to readjust the statements during the session of the board and then submit the information desired by them. He must necessarily think and act quickly in order to submit the data asked for, but had he come to the board

meeting fully prepared to give details and answer questions the delay would not have been occasioned. The auditor's duty is to have the statements so clearly arranged that they will exhibit the true conditions of the concern without much additional explanation, and yet collateral data should be at hand for submission to the client if desired by him. These details may or may not be included in the report, but they obviously ought to be available in the auditor's working sheets. We are told that the auditor submitted "an account properly named," in which he accounted for the decrease in resources, the increase in capital liabilities, and the disposition of profits. By comparing the surplus account and the amount of net profits for the year 1911, we find that they are not in harmony. Since no dividends have been paid, the year's profits added to last year's surplus should give the surplus for Dec. 31, 1911. On this basis the surplus should now be $36,170 instead of $31,920, as shown by the balance sheet. There is a difference somewhere of $4,250, which is found to be the amount allowed for depreciation reserve, thus indicating that depreciation had been taken out of surplus instead of having been charged against profits. We note also that the appreciation of real estate, $5,000, had been included in the profits for the year. The increase can hardly be considered part of the trading profits, but rather a capital increase which should be credited to surplus account. By omitting from the profit and loss account this appreciation and including the reserve for depreciation, we find the trading profits for 1911 to be $12,870, as shown by the accompanying adjusted statement. The surplus account is also shown in connection therewith.

The account prepared by the auditor may be called Cash Account, as it more clearly reflects the increases and decreases than could be shown by any other plan of adjustment. It might even be called Adjustment Account or Increase and Decrease Account, but in any case the increases and decreases must be exhibited in a manner that will be easily understood. The accompanying statements will exhibit a plan of adjustment, using the Cash Account as the main exhibit. By inspection it will be seen that the capital liabilities are increased by the issue of a bond and mortgage for $20,000. The proceeds of this loan, and other cash receipts, have been used largely to pay off outstanding promissory notes and to purchase investment bonds, requiring together a payment of $47,000. This answers in part for the decrease in cash, and while other receipts and payments are recorded, they are small in comparison with those already mentioned. In arriving at results a comparative balance sheet is of advantage for exhibiting increases and decreases, and while the problem does not call for this, it would form a part of the auditor's working papers.

CASH ACCOUNT.

Statement of Receipts and Payments of Cash for Year Ended December 31, 1911.

RECEIPTS.			PAYMENTS.		
Balance Jan. 1, 1911		$28,300.00	Bond Investments, cost		$14,000.00
Accts. Rec. 1, 1, '11	$29,600.00		Notes Payable		33,000.00
Accts. Rec. 12, 31, '11	26,550.00		Agency Investments		3,680.00
		3,050.00	Machinery and Tools		3,000.00
Cash Sales, less purchases, expenses, etc.		17,120.00	Purchases for year:		
Bond and Mortgage		20,000.00	Materials and supplies	$7,440.00	
			Deduct:		
			Amount owing on same	2,950.00	
					4,490.00
			Payments		$58,170.00
			Balance on hand		10,300.00
		$68,470.00			$68,470.00
Jan. 1, 1912, Balance on hand		$10,300.00			

Summary of Cash.

Balance January 1, 1911	$28,300.00
Receipts during year	40,170.00
Total Cash	$68,470.00
Payments for year	58,170.00
Balance on hand	$10,300.00
Decrease in Cash during year	$18,000.00

Note.—The amounts shown above are not all true, as balances are given in some cases. The amounts representing purchases and sales are obviously only the adjusted balances and do not represent totals. This is likewise true of accounts receivable and payable. In opposite column an Adjusted Income and Profit and Loss Account is shown for the year ended December 31, 1911.

EARNINGS.

Profit from Trading, less all Expenses, as stated	$22,120.00
Deduct Appreciation of Real Estate	5,000.00
Current Business Profit	$17,120.00

EXPENSES.

Depreciation of Buildings and Machinery, transferred from Surplus Account	4,250.00
Net Profit for Year	$12,870.00

Adjusted Surplus Account.

Surplus, January 1, 1911	$14,050.00
Net Profit for Year	12,870 00
Appreciation of Real Estate	5,000.00
Balance, December 31, 1911	$31,920.00

Problem No. 3.

Question in Auditing from the Final Examination of the Institute of Chartered Accountants of Ontario, 1912.

A. B. C. Company, Limited. Capital Stock Common Authorized, $800,000.00. Bonds Authorized, $500,000.00.

Statement of Assets and Liabilities, December 31, 1911.

ASSETS.			LIABILITIES.		
Cash on hand	$ 1.465.00		Owing to Bank	$ 65,650.00	
Accts. Receivable	287,670.00		Bills Payable	94,500.00	
Merchandise	273,287.00		Bonds Issued	450,000.00	
Machinery and Tools	365,000.00		Capital Stock	675,000.00	
Building	132,500.00				
Real Estate	241,328.00				
Investment in Capital Stock of X. Y. Z. Co., Ltd., (1000 shares, par value $100.00 each)	100,000.00	$1,401,250.00	At Credit of Profit and Loss	116,100.00	$1,401,250.00

Profit and Loss Account.

To Bond Interest for 1911	$ 27,000.00		By balance at credit Dec. 31, 1910	$115,500.00	
To Dividends for year 1910	54,000.00		By Net Earnings from Trading for year ending Dec. 31, 1911	81,600.00	$197,100.00
To Balance	116,100.00	$197,100.00			

The above tentative statements have been prepared at the close of the year in the office of the A. B. C. Company, Limited, of which you are the auditor. The following matters have been left to be dealt with by you.

(1) An error of $10,000.00 resulting in the undervaluation of the Inventory of Merchandise on hand to this extent at the close of the year 1910 had just been discovered.

(2) The Statement of the X. Y. Z. Company, Limited, shows undivided profits available which would warrant the Company in paying a dividend of 20% on its Capital Stock.
The Directors of the A. B. C. Company, Limited, therefore wish to incorporate in their Company's Statement and take credit for an amount equivalent to 20% on the stock held in the X. Y. Z. Company, Limited.

(3) A recent reliable valuation of the Company's Estate shows it to be worth at least $50,000.00 more than what it at present stands charged with in the books and it is desired that the statement show the Real Estate at this increased figure.

(4) The bank holds as collateral to the amount owing to it a block of the Company's bonds amounting to $50,000.00 which are not included in the amount shown on Statement above and which by arrangement does not bear interest unless certain conditions arise.
Assuming all else on Statements as originally prepared to be correct, draw up revised Statements after making adjustments in such form that you would feel justified as auditor in certifying to.

Answer and Comments:

This question is from the final examination in Auditing given to candidates for the degree of chartered accountant. The points contained therein emphasize the fact that the auditor should be able to think and to act independently with respect to the records which he is called upon to examine. He should not be so narrow in his views as to antagonize the interests of his clients, nor should he be persuaded to pass upon things which his better judgment tells him are beyond the line of conservatism. There are times when he can decide important matters only after an examination of collateral evidence and by the investigation of facts closely related to the work under review. The auditor should always lean towards conservatism, and in case matters come up which are difficult to decide, he should keep on the safe side and as far away from the danger line as possible. He should not ignore any suggestions, advice and information tendered by the directors and employes of the company which he is serving, and yet he should not be persuaded to follow their suggestions if there is any reason to doubt the advisability of doing so. It is natural that the managers of a concern should be optimistic regarding the future of their business and be desirous of making as good a showing as possible. On the other hand, the auditor is a semi-public official who safeguards the interests of both the company, the stockholders and the public by assuming an intermediate position, and he must therefore guard the interests of all concerned. It is his duty to see that the stockholders of a corporation are correctly informed as to the management and conduct of their interests. We shall now take up in order the points covered in the question.

(1) This error of $10,000 in undervaluing the inventory at the closing of 1910, resulted in the understatement of the profits for 1910, and their overstatement to the same extent for 1911. It is obvious that in order to present a true profit and loss statement, certain adjustments should be made in order that the profits of each year may be correctly stated. This is advisable on behalf of those interested in the company, and also for statistical and comparative purposes. While the amount is not large and might even be ignored in a company doing business on such large proportions, yet it does not seem wise to do so. When results are compared for a term of several years, it is most desirable that such yearly results should be reckoned on the same basis each time. The adjusting entry to be made in this case will depend upon conditions. If the accounts have not yet been closed for 1911, it will be an easy matter to make an entry debiting merchandise and crediting profit and loss account as of December 31, 1910, for $10,000. This would serve to correct the two accounts affected. In making this entry it is assumed that the balance of profit and loss account for 1910 is standing as a credit, as in the case of undivided profits account. Profits remaining therein at the end of each succeeding year would be carried to the current profit and loss account for apportionment. If an Undivided Profits or Surplus account were kept the current profits would be carried to it and then apportionment of dividends made.

If the accounts have already been closed it is apparent that merchandise account will show only the inventory of $273,287, and profit and loss account the credit balance of $116,100. No matter what plan is followed these

amounts will not be changed. The point at issue is to determine the exact profits for the year, and to make the profit and loss of each year show its correct status. We might re-open the accounts by debiting merchandise and crediting profit and loss as of December 31, 1910, for $10,000. Another entry would then be necessary debiting profit and loss and crediting merchandise as of December 31, 1911. This would bring each account to show its correct condition and thereby enable the bookkeeper or auditor at any future time to see very clearly what has been done. If journal entries are not to be made, then it is necessary to make a full explanation of the error in the journal; in that case a memo. should be placed in each account affected by the particular error and the adjustment set forth in the journal.

(2) Here is a condition that the auditor must look into very carefully before making a decision. If the X. Y. Z. Company is an underlying company it is evident that the directors of the A. B. C. Company would have control over its profits. In that case they may be able to give sufficient assurance that a dividend will be declared at the annual meeting which will take place soon. If the profits are ample to justify a 20% dividend and if they have been receiving regular dividends from the underlying company regularly in previous years, then it might be well to enter this one as dividends receivable. Before doing so, however, the auditor should make a careful investigation of the conditions in order to assure himself that the receipt of dividends is certain to take place. If dividends had been anticipated in previous years and then had been actually received, he would have a precedent to follow, providing the outlook at this time is equally as good. It does not seem as if dividends from the underlying company were received in 1911, which leads one to believe that they were entered if at all, as of December 31, 1910. This is a case wherein the auditor must exercise his best judgment in determining whether or not the directors are broad minded enough to desire a correct statement of results rather than the inflation of profits. In a company of this size it is apparent that the $20,000 will neither make nor mar its financial standing, therefore it would be a wise precaution to defer it until the dividend is actually declared. In any case, whether or not a contingent item of this kind is taken into the account, the auditor should draw special attention to it in his report, so that no one will be deceived thereby. The entry for bringing this $20,000 onto the books might be a debit to dividends receivable and a credit to profit and loss with a full explanation of the circumstances. It is stated that the directors wish to incorporate this amount in the company's statement. If they are prudent business men and have every reason to believe that the amount will be received, the auditor might safely comply with their wishes and then add a foot note to the statement calling attention to the fact that the dividend had not yet been declared.

(3) Since the revaluation of the company's real estate shows a permanent increase of $50,000, the auditor can not dispute the reports submitted by reliable appraisers. This amount, however, is a capital profit and should not be used for the payment of dividends; for that reason it would seem well not to place it to the credit of profit and loss. A good plan is to debit real estate and credit surplus account, or a special surplus account or even a special reserve account. In this question there is no surplus

account, but that need not deter us from opening an account under that name. In the accompanying profit and loss statement, this item has been included in order that all the items of profits and surplus may be shown together. A part of the profits should now be transferred to surplus. The form of statement used is one approved by leading accountants of today, and even some of the large corporations show their inventory adjustments in a similar manner.

(4) The company has an authorized bond issue of $500,000, of which $450,000 has been sold, while the remaining $50,000 is in the hands of the bankers as collateral security for a loan of $65,650. In reality the entire amount is issued and should be shown on the statement, but since the $50,000 are supposed to be treasury bonds and are merely held by the bank as collateral security, it is all right to deduct this amount from the aggregate issue. The amount of loan from the bank is represented in the loan account, and since it records the liability for which the bonds were given it is unnecessary to show a second liability. The bank loan may or may not be a long time loan, but in case of default in payment it is evident that the bonds may be sold for the satisfaction of the claim. If the bonds are sold it seems evident that the interest thereon will begin to run and have to be paid, but we can assume that so long as the bank loan is not in default the interest will not accrue. In any case, a foot note should be made to the balance sheet drawing attention to the contingent liability of bond interest which may, under certain conditions, have to be paid.

We are told to assume that all other accounts in the statements originally prepared are correct. We have prepared the revised statements as suggested and have also made adjusting journal entries to show the manner of making the required changes. The auditor's work is certainly interesting, and the better qualified he is in every respect the better service can he render to his clients, and the more dependable will he be in safeguarding the interests of the public.

THE A. B. C. COMPANY, LIMITED.

Statement of Assets and Liabilities as on December 31, 1911.

Assets.

Current Assets:		
Cash on hand	$ 1,465.00	
Accounts receivable, good	287,670.00	
Merchandise	273,287.00	$ 562,422.00
Investments:		
Stock of X. Y. Z. Company, 1,000 shares at $100	$100,000.00	
*Profits accrued on above	20,000.00	120,000.00
Fixed Properties:		
Real estate	$291,328.00	
Buildings	132,500.00	
Machinery and Tools	365,000.00	788,828.00
Total assets owned by company		$1,471,250.00

Liabilities and Capital.

Current Liabilities:		
Owing to bank, secured by bonds...........	$ 65,650.00	
Bills payable	94,500.00	160,150.00
Fixed Liabilities:		
Bonds issued and outstanding...............	$450,000.00	
*Bonds held by bank as collateral for amount owing, $50,000.00		450,000.00
Total liabilities owing by company..............		$ 610,150.00
Net worth of company.........................		$ 861,100.00
Made up as follows:		
Capital Stock outstanding.................. (Authorized $800,000.00)		$ 675,000.00
Balance to credit of Profit and Loss.........		186,100.00
Net Worth		$ 861,100.00

Note—*There is a contingent liability of interest on bonds held by the bank as security, since date of issue, in case certain stated conditions arise. A dividend of 20% on stock holdings is also assured but not yet declared.

Profit and Loss Account, Adjusted as on December 31, 1911.

CREDITS.

By balance at credit December 31, 1910			$115,500.00
Add profits for 1910, omitted because of undervaluation of merchandise inventory, Dec. 31, 1910, resulting in the understatement of profits..............			10,000.00
Correct Balance as of Dec. 31, 1910......			$125,500.00
Add earnings for 1911:			
Net earnings from trading for year ended Dec. 31, 1911, per the books..........		$ 81,600	
*From accrued profits on X. Y. Z. Company stock		20,000	
Total earnings for 1911..........		$101,600	
Deductions from earnings:			
To inventory adjustment from 1910......	$10,000		
To bond interest for 1911................	27,000		
To interest on collateral bonds...........	nil	37,000	
Net earnings—surplus for year 1911......			64,600.00
Profits available for apportionment.......			190,100.00

Other Additions:	
Increase in value of real estate in accordance with appraisement............	50,000.00
Total Credits	$240,100.00
Dividends Paid:	
Dividend for year 1910, paid in 1911......	54,000.00
Balance, Surplus Profits, Dec. 31, 1911.. ..	$186,100.00

*A 20% dividend is assured but not yet declared—if passed this amount must be omitted.

Adjusting Book Entries, December 31, 1911.

(1)	Profit and Loss, 1911..........................	$10,000.00	
	To Profit and Loss, 1910.............		$10,000.00
	To adjust profits of 1910 that had been understated because of undervaluing inventory of merchandise. This results in the lessening of profits for 1911, which were overstated by this amount.		
(2)	Dividend receivable X. Y. Z. Company..........	20,000.00	
	To Profit and Loss...................		20,000.00
	For dividend of 20% on the holdings of X. Y. Z. Company stock, assured by the directors of X. Y. Z. Company, but not yet declared. 20% of $100,000, our holdings.		
(3)	Real Estate	50,000.00	
	To Surplus (or Profit and Loss).......		50,000.00
	For increase in value of real estate, per recent appraisement, entered per order of the board of directors.		
(4)	Collateral Treasury Bonds.....................	50,000.00	
	To Bonds Payable....................		50,000.00
	To place on the books bonds to this extent given to the bank as security for the loan of $65,650.		
	There is a contingent liability in respect to interest on these bonds payable by arrangement only in case certain conditions arise. Perhaps interest for one year on $50,000, $3,000.		

Problem No. 4.

Report of Commissioner of Corporations.

FOLLOWING is a trial balance of X Y Z Co. on January 1, 1912:

DEBITS.		CREDITS.	
Cash ....$	8,400	Notes receivable, discounted...$	25,000
Labor	205,000	Reserve depn. real estate......	10,000
Royalties	20,000	Reserve depn. machinery......	10,000
Selling expense	50,000	Merchandise sales	1,000,000
Mdse. purchases, to Jan. 1, 1912	600,000	Surplus	37,000
Notes receivable	40,000	Capital stock	100,000
Mdse. inventory, Jan. 1, 1911...	100,000	Interest earned	500
Accounts receivable	100,000	Accrued pay roll.............	3,000
Machinery	40,000	Accounts payable	20,000
Real estate	60,000	Mortgage real estate..........	30,000
Investments in other companies	30,000	Trust receipts issued under letters of credit...............	150,000
Interest paid	10,000	Notes payable	60,000
Tax account	800		
Bad debts	1,600		
Manufacturing expense	150,000		
Discounts allowed	27,000		
Marine insurance	2,700		
	$1,445,500		$1,445,500

Inventory, January 1, 1912, was $200,000.

On Merchandise imported under L/C for which trust receipts were given, it is found that $60,000 is on hand, $30,000 is represented by Accounts Receivable at face value of $55,000, and $30,00 has been sold and paid for.

$20,000 of Investments have been pledged as collected for $35,000 Notes Payable.

Merchandise is bought on Net 30 days.

Manufactured goods are sold on 3% 30 days, and all customers settle accordingly.

Accrued Taxes not paid, January 1, 1912, were $400.

Submit State of Condition, Working Account and Statement for Commissioner of Corporations.

Comments on the Problem.

The accompanying question from the Massachusetts examination of June, 1912, is from the paper on Practical Accounting and was required to be worked in three hours. The question is not hard and does not present any specially difficult points, though the details pertaining to importing, trust receipts and letters of credit are rather hard to interpret. A few of the terms used, also, seem to be peculiar to Massachusetts, as will be noticed by an examination of the question. The question calls for a "working account," which is practically a revenue or profit and loss account. It also asks for a statement for the Commissioner of Corporations, which means an annual statement as required by every corporation doing business in Massachusetts. A "statement of condition" means a statement of assets and liabilities. All of the statements called for are shown herewith and an examination of them will indicate how the various items should be handled.

Corporation Reports.

In nearly every state, corporations doing business therein are required to make annual reports to some official designated by statute. In Massachusetts this official is called Commissioner of Corporations. Blank forms are usually furnished for that purpose and sometimes they are required to be filed in duplicate. Foreign corporations generally report on the same blanks as domestic corporations, though in some states a special blank is provided for their use, but it does not differ very much from the domestic form. In some of the states the reports are very elaborate, and though Massachusetts is fairly inquisitive, it is not equal in that respect to Pennsylvania and some of the other states. The reports are required by law and must be filed on or before a given date, varying of course in the different states. Some require that they be filed as of December 31, while others permit them to be filed within a given time after the company ends its fiscal year, whether in December, June or any other month of the year. Note that the accompanying Massachusetts report for the Commissioner of Corporations requires among other things a statement of assets and liabilities, also the names of the officers and directors. Another excellent requirement in Massachusetts is that every corporation whose capital is $100,000 or over, must have an auditor's certificate attached to the report, thus necessitating the employment of an auditor. This is indicated by the auditor's certificate shown in the accompanying report. The auditor must not be a bookkeeper, treasurer, or any other officer of the corporation whose report he has signed. This is undoubtedly an excellent requirement which some time may be required in all of the states. In addition to the state report a revenue report is required to be filed with the Department of Internal Revenue and on the net profits over and above $5,000 a corporation tax of 1% is levied by the United States Government.

Annual Tax.

In most states all corporations are required to pay an annual tax on the amount of outstanding capital stock, and in some there is also an additional filing fee. An annual tax or franchise tax is nearly always required of foreign corporations (those chartered in other states) in addition to the regular filing fees, and sometimes in addition to the license which is imposed. The annual taxes differ in the various states. It must be kept in mind, however, that the annual corporation tax is separate and distinct from the regular property tax levied by municipalities on individuals and corporations. The annual franchise tax is imposed in Massachusetts, but the rate is adjusted annually to meet the state needs. The tax is computed upon a corrected franchise value ascertained as follows:

The Tax Commissioner, from returns made by the corporation or "in any other manner," determines the market value of the stock and from that estimates its fair cash value on May 1 preceding. This is the franchise value, and from it is deducted the assessed value of real estate and machinery subject to local taxation, and any securities which are in the hands of an individual would be exempt from taxation. A further deduction is made on the value of any corporate property paying taxes outside of the state. It is upon the franchise value as thus corrected that the

tax is levied. In no case, however, is the corrected franchise value to exceed 20% of the entire corporate property, nor shall the tax ever be less than 1/10 of 1% of the market value of the capital stock. The annual tax is required to be filed by the treasurer with the Tax Commissioner between May 1st and May 10th as of May 1st preceding. This gives in detail the information desired by the Commissioner in deciding upon the amount of tax to be paid by each corporation, and must necessarily be exhaustive and include the names of all stockholders.

Foreign corporations, before doing business in Massachusetts, are required to file with the Commissioner of Corporations a copy of their charter, certificate of incorporation and give full information pertaining to the company, sworn to by the treasurer, president and directors. The filing fee or license is $25, and every other certificate, including the annual report to the Secretary of the Commonwealth, is $5. An excise tax is imposed on foreign corporations of 1/100 of 1% of the par value of its assessed capital stock, as shown by its annual certificate of condition; and local taxes paid on property in the state may be deducted and such excise tax is never to exceed $2,000. These details regarding Massachusetts taxes are taken from Overland's Classified Corporation Laws, published in 1907.

The $20,000 of collateral pledged as security for the loan of $35,000 should be indicated in the balance sheet in connection with the item of Investments or else as a footnote. Since manufactured goods are sold on 3 per cent discount, it is safe to make allowance for this in the statement, but in doing so it is sometimes necessary to look back to the close of the previous month or the previous fiscal period to see whether or not it had been considered at that time. In a large corporation an item of this kind, unless it amounts to a considerable sum, is often permitted to overlap. It is best, however, that all accruals or allowances should be considered. In this solution the 3% discount is taken on the entire $100,000 of accounts receivable, but since the discount is allowed only on sales of manufactured goods it is evident that a distinction should be made. Apparently the imported goods were sold without undergoing any change, in which case the $55,000 now due from customers should be deducted from the accounts receivable and the remaining $35,000 considered as due from sales of manufactured goods. In that case the reserve for discount would be $1,350 instead of $3,000, with a corresponding increase in the net results shown by the statements. In the event of this discrimination a closer division should be made between the manufacturing and trading accounts. The matter of depreciation has been omitted, but a consideration of an addition to the reserves would have been in order. Notes receivable under discount at the bank are shown as a deduction from notes receivable account, thus leaving a balance on hand of $15,000. Instead of deducting them in this way they are sometimes included among the liabilities; indeed, they are often omitted from the balance sheet entirely and mentioned in a footnote, in order that the contingent liability may not be overlooked.

Importing Goods.

The importing business and the numerous details connected therewith can only be touched upon briefly in this contribution. The importer either

pays for the goods by sending a bank draft direct to the exporter or by permitting him to ship the goods subject to draft (bill of exchange), either sight or time. In some cases the bill of lading is attached to the draft and sent through a bank, and the draft must be paid before the bill of lading can be released. The method adopted depends largely upon the credit rating of the importer.

Another plan of paying for imported merchandise is by commercial letter of credit issued by banks to their customers for sending abroad. The L/C may be purchased outright by the importer, but it is usually issued by the banker on the customer's credit and paid for after the goods have been received and sold. The letter of credit is a document issued by a bank for its customers in favor of the foreign merchant from whom the goods are purchased, authorizing him to draw on said bank or its London or Paris correspondent for a given amount. The draft is then paid by the European correspondent and sent on with bill of lading, consular invoice and insurance policy to the bank which originally issued the letter of credit. The importer then receives from his bank the bill of lading, at which time he either pays or "accepts" the draft or issues a trust receipt. At the time of issuing the letter of credit the bank receives from the importer a written agreement granting to the bank a lien of all goods engaged for importation thereunder and pledging the goods as security for the full payment thereof. The bill of lading, as already stated, is received from the bank and a trust receipt issued in its favor for the amount of the indebtedness. The trust receipt is usually paid in installments as the goods are sold and paid for. In the meantime the goods are held in trust either by the importer himself or in some warehouse whose receipt is issued to the bank. If his credit is good he is permitted to take them himself and turn over the proceeds of sales as payment for the trust receipt, otherwise they are released to him from the warehouse only when a sale has been made.

In the question under consideration the merchandise was evidently delivered over to the importer and his trust receipts issued to the bank; but since the outstanding trust receipts aggregate $150,000, there should still be in trust goods to that amount. Where are the goods? As the merchandise is sold the avails thereof are paid over to the bank, though sometimes this is not done with any degree of promptness. We will assume, however, that the $30,000 sold and paid for has been turned over to the bank to liquidate trust receipts. That amount, then, is not to be considered further. The other $30,000 sold and not yet paid for, is still subject to the trust agreement, and as soon as it is paid for the required amount will be turned over to the bank and an equivalent of trust receipts cancelled. This still leaves $120,000 of trust receipts outstanding, and we are told that merchandise to the extent of $60,000 is on hand. There is still another $60,000 of merchandise represented by trust receipts that must be accounted for, which we will assume to be either in transit or in some bonded warehouse. Now, then, the inventory of January 1, 1912, should be increased to $260,000 in order to include the merchandise not yet received into stock. It evidently was entered up to merchandise account when the trust receipts were issued, and therefore should now be included in the inventory. This assumption may differ from that of the examiner

who prepared the question, yet since the practice varies considerably we are justified in following the plan which prevails in the majority of cases; that is, of turning over to the bank the cash as it is collected from customers. We therefore have a net profit of $90,000 which seems out of proportion to the capital invested, yet in solving a question that is subject to different interpretations one must necessarily assume a basis and proceed accordingly. If the $30,000 received from cash sales has not yet been applied to the liquidation of trust receipts, then the net profit is reduced to $60,000 and the goods in transit to $30,000. It is assumed, of course, that the inventory of $200,000 includes only the $60,000 of trust merchandise on hand.

Analysis of Imported Merchandise Account Under Which Trust Receipts Were Issued.

Total issue of trust receipts		$180,000.00
Redeemed from proceeds of cash sales		30,000.00
Balance unpaid		$150,000.00
Represented by:		
Goods on hand	$ 60,000.00	
Goods sold but not yet paid for	30,000.00	
Goods in transit or in bonded warehouse	60,000.00	
Merchandise inventory:		
Goods on hand		$200,000.00
Goods in transit or in bonded warehouse		60,000.00
Total inventory		$260,000.00

EXHIBIT A.
Statement of Condition, January 1, 1912.

Assets.

Current Assets:			
Cash		$ 8,400.00	
Accounts Receivable		100,000.00	
Notes Receivable	$40,000.00		
Less Notes Rec. Discounted	25,000.00		
		15,000.00	
Merchandise Inventory		200,000.00	
Merchandise in transit and in bonded warehouse.		60,000.00	
Investments in other companies		30,000.00	
Total Current Assets			$413,400.00
Fixed Assets:			
Real Estate	$60,000.00		
Less Reserve for Depreciation	10,000.00	50,000.00	
Machinery	$40,000.00		
Less Reserve for Depreciation	10,000.00	30,000.00	
Total Fixed Assets			80,000.00
Total Assets			$493,400.00

Liabilities and Net Worth.

Accrued Liabilities:			
Accounts payable		$ 20,000.00	
Notes payable		60,000.00	
Trust receipts		150,000.00	
Items Acrued, but not due:			
Pay roll	$3,000.00		
Taxes	400.00	3,400.00	
Total Current Liabilities			$233,400.00
Mortgage on real estate			30,000.00
Reserve for Discount			3,000.00
Capital Stock		$100,000.00	
Surplus:			
Balance Jan. 1, 1911	$37,000.00		
Net Profit year ended Dec. 31, 1911 (See Exhibit D)	90,000.00	127,000.00	
Net worth of Company			227,000.00
Total Liabilities and Net worth			$493,400.00

EXHIBIT B.

Manufacturing Account for Year Ended December 31, 1911.

Merchandise Inventory, Jan. 1, 1911		$100,000.00	
Merchandise purchased to Jan. 1, 1912		600,000.00	
		$700,000.00	
Deduct:			
Merchandise Inventory, Jan. 1, 1912		260,000.00	
			$440,000 00
Labor			205,000.00
Manufacturing Expense			150,000.00
Marine Insurance			2,700.00
Taxes Real Estate paid		$800.00	
Taxes Accrued		400.00	
			1,200.00
Royalties			20,000.00
Cost of Goods Manufactured			$818,900.00

EXHIBIT C.

Trading Account for Year Ended December 31, 1911.

Sales for year	$1,000,000.00
Deduct:	
Cost of Goods Sold as per Manufacturing Account	818,900.00
	$181,100.00

Deduct:		
Selling Expense		50,000.00
Gross Profit carried to Profit and Loss Account		$ 131,100.00

EXHIBIT D.

Profit and Loss Account for Year Ended December 31, 1911.

Gross Profit as per Trading Account		$131,100.00
Interest earned		500.00
		$131,600.00
Expenses and Charges:		
Interest paid	$10,000.00	
Bad debts	1,600.00	
Discount allowed	27,000.00	
Reserve for Discount	3,000.00	
		41,600.00
Net Profit for the year		$ 90,000.00
Surplus January 1, 1911		$ 37,000.00
Surplus December 31, 1911		$127,000.00

Statement for Commissioner of Corporations.

(Proper First Name Should Be Written in Full—Initials and Abbreviations Are Not Sufficient.)

(Acts of 1903, Chap. 437.)

Section 45. Every corporation shall annually, within thirty days after date fixed in its by-laws for its annual meeting last preceding the date of such report, or within thirty days after the final adjournment of such meeting, but not more than three months after the date fixed for said meeting, prepare a report of conditions which shall be signed and sworn to by its president, treasurer and at least a majority of its directors.

(The blank for this report is a prepared form which can readily be filled out from the report made to the stockholders, and corporations with a capital stock of $100,000 or more, must have it certified to and by an appointed Auditor. Among other things it must include a statement of assets and liabilities at the end of the fiscal year, which in this case would be as follows:)

Assets.

Real Estate	$ 50,000.00
Machinery	30,000.00
Merchandise including:	
Manufactures, merchandise, material and stock in process	260,000.00
Cash and debts receivable	153,400.00
Patent rights	None
Trade-marks	None
Good-will	None
Total	$493,400.00

Liabilities.

Capital Stock	$100,000.00
Accounts payable	20,000.00
Funded indebtedness	30,000.00
Floating indebtedness	213,400.00
Surplus	37,000.00
Profit and loss	90,000.00
Reserve for Discount	3,000.00
Total	$493,400.00

PART FOUR

Commercial Law

AGENCIES.

1. Who may be principals in a contract of agency?

Ans. In general, whatever a man may do in his own right, he may do by an agent. Any person legally competent to make contracts may act through an agent. Formerly a married woman could not employ another to act for her, since all her contracts were voidable, but with the removal of the wife's disabilities in most jurisdictions, she may appoint her husband or anyone else to do those things which she may do herself. A partnership may employ agents. Joint tenants may appoint agents, but one of two joint tenants cannot employ an agent whose acts will bind the other joint tenant. Corporations may employ such agents as are necessary to conduct the business for which they are organized.

2. Who are not competent to become principals?

Ans. In general, all persons who are not competent to make contracts, as enumerated in the previous question, are not competent to employ agents. Persons naturally incompetent, such as lunatics, idiots, and persons of unsound mind, cannot appoint agents. A drunken person cannot appoint an agent, though he may ratify, when sober, an appointment made while intoxicated. An infant may not appoint an agent. No agent can be appointed by a citizen of one country or state to act in another country or state during a time of war between such countries or states.

3. Who may become agents?

Ans. The same qualifications are not required for agents as are required for principals. As a general rule, any person of sound mind may become agent for another. An infant, except one of very tender years, may become an agent and his contract be binding upon his principal. A married woman, even where she is prohibited from making contracts in her own right, may become agent for her husband, and bind him by her contracts in that capacity. Or she may become agent for a third person even in contracts with her husband. The husband may become the agent of the wife to do those things she is permitted to do in her own right.

4. Who may not become agents?

Ans. An idiot, lunatic, or person of unsound mind is not competent to act as agent, for he is not endowed with sufficient discretion or understanding to make contracts for his principal. For the same reason, an infant of very tender years is incompetent to act as agent.

5. What is necessary to the creation of the relation of **principal and agent?**

Ans. To create an agency, an appointment is necessary; the appointment may be express or it may be implied from the acts and relationship of the parties, or in some cases it may be presumed by law.

6. How are express appointments of agents made?

Ans. Generally, the authority given to an agent to execute an instrument under seal, such as executing a deed to real estate, must be in writing under seal. This is the most formal kind of express authority to the agent. Express authority may also be given in writing, not under seal, when acts may be done by the agent without executing a sealed instrument, or orally, when written authority is not made necessary by statute.

7. When is written authority under seal necessary in order to permit the agent to act so as to bind his principal?

Ans. All acts conveying land, or any interest in land, or the signing of bonds for the principal which are required to be under seal, must be authorized by a writing under seal. Such an instrument is generally known as a "power of attorney" and the agent acting under it as "attorney in fact."

8. How may an implied agency arise?

Ans. From the relation of the parties to each other and from their conduct. One person may stand in such relation to another that the law will presume that his acts are authorized by the other as principal. Thus, the wife is the agent of the husband in the purchase of household necessities. As to other acts, she must have express authority. An attorney who acts for a party in court is presumed to have authority until the contrary is shown. A partner is the general agent of the co-partnership in all matters within the scope of the partnership business.

Agency may be implied from the conduct of the parties. Where one person holds another out as his agent, or permits the other to hold himself out as his agent and remains silent, he is prevented from denying the other's authority to act as such agent, and is bound by his acts, even though he has never given him express authority. Where one ratifies another's acts, the agency is implied, even though there had been no express authority in the first place.

9. Can the authority of the agent be delegated by him to a third party?

Ans. Generally, it cannot. As the power conferred by the principal upon the agent depends upon some special trust or confidence, the former places in the latter, his authority cannot be delegated. And so public officers, the officers of corporations, personal representatives and trustees, attorneys at law, brokers, and all classes of agents in whom some peculiar personal trust or confidence is placed, or who are empowered to perform acts which require some especial skill or confidence, cannot delegate their authority. But agents employed to perform purely ministerial, executive

or mechanical duties may authorize others to perform them. The usage and custom of a particular occupation may govern, as, for instance, a bank has implied authority to appoint another bank in a distant city to collect on a note, or a broker may act through a broker in another city.

10. Is the principal or the agent responsible for the acts of the sub-agent?

Ans. Where authority is expressly given to the agent to employ sub-agents or such authority may fairly be implied from the nature of the agency, the principal alone is responsible for the acts of the sub-agent, and the original agent is only responsible if he has been guilty of fraud or gross negligence in the appointment of the sub-agent. And an agent will not be responsible for any acts of a sub-agent appointed by the principal and placed under him.

11. What are the two principal classes of agencies?

Ans. An agent may be a general agent or a special agent. A general agent is one who is authorized to do all acts connected with a particular trade or business. A special agent is one who is authorized to do only certain specific things in accordance with particular instructions or within particular restrictions implied from the act to be done.

12. What is the duty of a third person with respect to the agent's authority, if he would bind the principal?

Ans. Third persons must ascertain the scope of the agent's authority and are put on their guard to do so by the very fact of the existence of the agency. The mere statement by the agent of his authority does not bind the principal. Where the agent's authority is in writing, the third party is presumed to know its scope. But the principal is bound by all acts of the agent within apparent scope of his authority. The authority of a general agent, however, is not unlimited and is restricted to the acts within the scope of his principal's business. If he exceeds that authority, the principal is not bound. The authority of a special agent must be strictly followed and the principal is not bound if the agent exceeds his authority.

13. Of what effect are instructions to the agent modifying his authority upon the rights of third persons to hold the principal liable for the agent's acts?

Ans. If the instructions are private, and the acts done are within the scope of the agent's apparent authority, the principal is liable for such acts, but if the third persons were informed or were otherwise aware of the modification of the agent's authority, the principal is not liable for acts done in violation of such modification of the agent's authority.

14. Of what effect is usage or custom in determining the scope of the agent's authority?

Ans. Third persons, dealing with an agent and having no means of knowing of the existence of any specific limitations upon that agent's

authority, have the right to presume that the agent possesses all the authority which is usually given to such agents in the particular line of business in which the principal is engaged, and a power given to an agent carries with it the right to do whatever is usual and necessary in order to carry into effect that particular power.

15. How is a general authority to the agent to sell goods to be construed?

Ans. The agent's authority, if not ambiguous, must be construed strictly, and an agent having the bare authority to sell goods, must sell for cash. It does not carry with it the authority to exchange, to accept securities, to extend credit, or to take anything in exchange for goods except cash. However, usage may govern, and where the custom of the particular business is to extend credit, the agent's authority may be construed as permitting him to extend the usual and customary terms.

16. Can an agent bind his principal by executing or indorsing a promissory note?

Ans. The agent's power to give or indorse a promissory note must be express, thought it may sometimes be implied from usage or custom. Authority to make or indorse negotiable paper will be very strictly construed, and he cannot bind his principal by execution or indorsement of paper differing in amount or time from that authorized.

17. Is there any difference in the legal effect of an instrument signed "John Smith, Agent for William Brown" and one signed "William Brown, by John Smith, Agent?"

Ans. There is no legal difference in the effect of either signature. Either would bind the principal if the necessary authority existed. The latter form of signature, however, is preferable and generally used.

18. When an agent has authority to execute a promissory note for his principal, will the validity of the note be affected by the agent's signning merely with his principal's name, and omitting his own signature?

Ans. No. But the better practice by far is for the agent to sign both his own name and the principal's, so that the names of all parties connected with the instrument shall appear on the instrument itself.

19. When an agent signs a note merely with his own name as agent, and does not disclose the name of his principal, whose note is it?

Ans. It is the obligation of the agent alone and not of the principal.

20. A note is indorsed by a bank cashier in his official capacity as "John Smith, Cashier," without adding the name of the principal . Is this the indorsement of the bank or of John Smith as an individual?

Ans. The same strictness is not required in the case of execution of negotiable instruments by officers of a bank as is required of other agents. Such indorsement would be the indorsement of the bank, the term "Cashier" sufficiently designating the principal.

21. When authority to bind the principal in matters of a private nature is conferred upon two or more agents jointly, will the acts of one bind the principal?

Ans. No. Unless it is clear from the terms of the authority that either or both may act, one of two joint agents cannot bind the principal without the consent of the other.

22. What in general is the duty of the agent toward his principal?

Ans. The agent must follow strictly the instructions of his principal with respect to carrying out the contract of agency. If he fails to do this, he breaks his contract and may be dismissed and may also be held to damages for such breach.

23. When the agent is not to get pay for his services and has not yet entered upon the performance of his duties as agent, is he liable for any damages resulting from his failure to follow his principal's instructions?

Ans. No. But even though the agency be non-remunerative, and the agent has once entered upon the performance of his duties, he will be responsible for any breach, even though the agency be gratuitous.

24. Will the agent be liable for neglecting to follow his principal's instructions, where by so doing, he would be compelled to do an illegal or an immoral act?

Ans. Manifestly no. Nor would such failure to follow instructions result in such a breach as would permit the principal to abrogate the contract of agency.

25. Where the agent's failure to follow directions was due to some necessity or emergency, will he be liable for such failure?

Ans. Not if such necessity or emergency was not created by his own default and he used his best judgment in behalf of his principal. This does not, however, justify the agent in assuming any unauthorized powers that are not absolutely necessary to protect his principal.

26. In the absence of specific instructions, how may the agent guide his conduct?

Ans. He is bound to follow the established usage or custom of the particular line of business on which he is employed, but no usage or custom justifies him in disregarding or violating express instructions.

27. What amount of skill or diligence is the agent required to possess or exercise?

Ans. An agent is understood to contract for the possession and exercise of ordinary skill and diligence, that is, for the skill possessed ordinarily by persons of common capacity engaged in that particular line of business, and that he will exercise that degree of diligence which persons of common prudence exercise in their own business, and he is liable for any injury to his principal occasioned by his lack of ordinary skill or by his ordinary negligence.

28. Is it the duty of the agent to insure the property of his principal which he may have in charge?

Ans. No, but if he has received instructions to insure or has been in the habit of insuring under similar circumstances, or it is the usage and custom in such transactions to insure, he will be liable himself as insurer for any loss arising from his failure to insure, or from his imperfect execution of insurance.

29. Is it the agent's duty to keep his principal regularly informed of matters material to his interest?

Ans. It is, and he will be liable in damages to his principal for any loss sustained through his failure to keep his principal regularly informed of his transactions.

30. In purely gratuitous agencies, what is the degree of responsibility of agent to principal?

Ans. The unremunerative agent is held to a much lower degree of responsibility than the agent for hire, and will be only responsible in cases of gross negligence, or willful and malicious fraud. But one who holds himself out as possessing peculiar skill or knowledge in his business or profession is held to the same degree of care and the same liability as an agent for reward, even though he is to receive no compensation for his services.

31. To what extent is the agent a trustee for his principal?

Ans. The agent must exercise the utmost good faith and loyalty toward his principal. He must not assume a position antagonistic to his principal, nor speculate in the subject of the agency, nor employ the principal's property for his own use, nor act both for his principal and for some other person with whom he deals on behalf of his principal.

32. May an agent, authorized to purchase, purchase for himself, or one authorized to sell, sell to himself?

Ans. Not without his principal's knowledge and his consent thereto. Any act of the agent's in conflict with the principal's best interests is in the nature of a breach of trust.

33. What is the agent's duty with regard to his principal's property?

Ans. The agent must not commingle his principal's property with his own, and if he allows them to become so commingled as afterwards to be indistinguishable, the whole will belong to the principal.

34. What is meant by the ratification of the acts of an agent by the principal and what is its significance?

Ans. Ratification is the acceptance or adoption of the acts of another done for one without his authority and has the effect of establishing the rights and obligations of an agency. No new additional consideration is required to support the ratification.

35. What acts may be ratified?

Ans. Generally, only those acts which could have been authorized in the first instance. Void or voidable acts may not be ratified, nor fraudulent acts which involve crime.

36. Must the ratification necessarily be express?

Ans. No. Ratification may arise by implication from the conduct of the person for whom the act is done. Ratification may arise from previous acts of the principal under similar circumstances. And where one accepts the profits or benefits of an act done for him, ratification of that act is the result, without any express acceptance of it as the act of his agent, and even against his express disavowal of the act. And even mere silence may amount to a ratification, where the principal with full knowledge that the unauthorized act has been done for him, neglects to disavow it, as the act of his agent. He should disavow it, within a reasonable time.

37. Can the ratification of the act of an agent be revoked?

Ans. No. When once made the principal is bound. But a disavowal of the agent's act may be withdrawn and the act ratified, provided that between the disavowal and subsequent ratification, the third party has not abandoned the contract.

38. When may the authority of an agent be revoked?

Ans. When no definite term has been agreed upon the principal may revoke his authority at any time. And when the agreement, even for a definite term, is based upon the proviso that the agent prove satisfactory to the principal, he may revoke whenever he may feel justified in doing so.

39. In what manner may an agency be revoked?

Ans. Revocation may be effected in any manner showing the intention of the principal to withdraw his authority. It may be express or may arise by implication from his acts. Even an authority in writing may be revoked verbally.

40. When does an agent's right to his compensation attach?

Ans. When the services for which he was employed have been fully and faithfully performed, no matter whether they have been profitable to his principal or not.

CONTRACTS.

1. What are the essential elements of a valid contract?

Ans. There must be a meeting of the minds of the parties with respect to their intention, which takes the form of an offer and an acceptance. There must be a valuable consideration. The parties must have capacity to contract. The objects of the contract must be legal. To create a valid contract the acceptance must be absolute and identical with the terms of the offer.

2. What contracts, generally, should be in writing in order to be enforced at law?

Ans. A promise to answer for the debts of another must be in writing. Contracts for the sale of real estate or any interest in real estate must be in writing, if they are to be enforced. Any agreement that is not to be performed within one year from its date, must be in writing. The most common illustration of this is in the case of leases which are valid for one year if made orally, but must be in writing to hold either landlord or tenant for more than a year. Generally, a contract for the sale of personal property for the price of $50 and upwards should be in writing, unless part of the goods sold are delivered, and accepted, or part of the purchase price paid to bind the bargain.

3. How does every contract originate?

Ans. Every contract arises out of an offer by one party and an acceptance by the other.

4. What is an executory contract?

Ans. An executory contract is one which is wholly unperformed, or in which something still remains to be done on both sides, as where A undertakes to deliver goods to B at some future time, for which B is to pay in the future.

5. What is an implied contract?

Ans. A contract is frequently implied by the law from the conduct of parties and the surrounding circumstances. If one orders goods delivered from a store, a contract is implied that he will pay for them at a reasonable price.

6. How may a contract once entered into be discharged?

Ans. It may be discharged by agreement between the parties who are bound by it. This is called waiving, canceling, or rescinding the contract, and is in fact a new contract, subject to the test of mutuality, consideration, etc. One party cannot discharge the contract without the consent of the other. A contract may be discharged by its performance. When all things undertaken by the parties have been done and all rights satisfied, the contract is discharged. The contract may be discharged by breach. This creates a new obligation on the part of the party committing the breach and the other party may have a right of action by reason of such breach. A contract may be discharged by reason of its becoming impossible to perform it. A man may contract to perform certain services and may be incapacitated by illness or may die. This would operate to discharge the contract. A contract may also be discharged by operation of law. A man may be discharged from all contracts by bankruptcy, for instance.

7. What rights under a contract may be assigned?

Ans. Money due or property rights under a contract can be assigned, but the rights to personal services cannot be assigned, without the consent of the other party to the contract.

8. What constitutes a valuable consideration, such as is necessary to the validity of a contract?

Ans. A valuable consideration is something that has some value in the eyes of the law. It need not be money or goods. A promise is a valuable consideration; so also is forbearance to do something which one is entitled to do. The consideration need not be adequate so long as it is of some value. So the sale of valuable goods "in consideration of one dollar" is a contract supported by a valuable consideration. The consideration must be legal. The doing of an illegal act or the promise to do an illegal act can never be a valid consideration for a contract. The consideration must be present or future but never past.

9. If an offer is made by mail and an acceptance is returned by mail, when is the contract concluded?

Ans. When a mail acceptance is sent to a mail offer, the contract is concluded the moment the acceptance is placed in the mails properly addressed to the person making the offer and carrying sufficient postage. The fact that the letter of acceptance may be delayed, or may never be received does not affect the rights of the parties to enforce the contract.

10. One manufacturer agreed with another engaged in the same business, in consideration of $1,500 to cease manufacturing certain articles for one year. Can the contract be enforced?

Ans. This is a contract in restraint of trade and so is void as against public policy. Contracts may be void because the thing done is prohibited by statute or by the common law, or they may be void because the courts hold them to be against public policy. The various trust laws are laws prohibiting contracts in restraint of trade.

11. One of the creditors of an insolvent estate withdrew his aid from a suit pending in the interest of all the creditors, upon defendant's promise to pay his claim in full. Can he enforce such a contract?

Ans. Such a contract is void on the grounds of public policy. A promise which seeks to secure to one of several who are acting in a matter of common interest a secret advantage over his associates, is a promise to commit a civil wrong and so is void as being against public policy.

12. James Black wrote to William Tomlinson offering him one hundred barrels of apples at $3 per barrel. Tomlinson replied, "I accept your offer, you guaranteeing apples to be shipped immediately and free from all defects." The market price of apples rose within the next week one dollar per barrel, and no apples arriving Tomlinson wired, asking why his apples had not been shipped. To this Black replied that he had sold the apples elsewhere and was not shipping any to him. Tomlinson then brought suit for the one dollar per barrel advance in price. Can he recover? State the reasons for your answer.

Ans. In order to make a contract complete and binding on all parties there must be an offer made by one of the parties to the other, which offer must be accepted without any qualifications. In the case stated, Tomlin-

son only accepted the offer under the express condition that the party making the offer guarantee the apples to be shipped immediately and free from all defects. A contract was, therefore, not made, and Black was not obliged to ship the apples. Tomlinson was, therefore, not entitled to recover.

13 When the contract calls for payment of money, what performance is necessary?

Ans. A contract where the consideration is the payment of money or the promise to pay money is only performed when the exact amount agreed upon is paid, with legal interest from the time payment is due until the amount is paid.

14. Where no place or manner of payment is specified in the contract, how is the debtor under obligation to make payment?

Ans. Where there is no specified place or manner of payment, the debtor's duty is to make the payment personally to the creditor, but if the creditor receives the payment in any other manner, the debt is discharged.

15. What are contracts of record?

Ans. Contracts of record are contracts which prove themselves, that is, contracts which merely have to be produced in order to prove the evidence of their existence. Such contracts are judgments, recognizances and the like.

16. What is a formal contract?

Ans. A formal contract is one which depends for its validity upon its form rather than upon other essentials. A contract under seal is practically the only kind of formal contract.

17, What is the advantage of a formal contract?

Ans. In a formal contract the consideration need not be proved. It is implied from the fact of their being a seal.

18. What is a consideration?

Ans. A consideration is that which the law regards as the inducement for entering into a contract.

19. What are the characteristics of a valuable consideration?

Ans. Anything that is of profit or benefit to the party making the promise, or is of detriment or inconvenience to the party to whom the promise is made is a valuable consideration. A valuable consideration need not be money or property. A promise to do a particular thing is a valuable consideration, so also is a forbearance to do a thing which one is entitled to do.

20. In what forms may an offer be made?

Ans. An offer may be made of an act in exchange for a promise, as where one promises to deliver goods or to perform a service in exchange for a promise to pay for such goods or service.

An offer of a promise may be made in exchange for an act, as where one offers to promise to pay for goods delivered to him or for services rendered.

An offer of a promise may be made in exchange for a promise, as where one promises to pay at some future time if the other party gives in exchange a promise to deliver goods or perform some service at a future time.

21. How may an offer be communicated?

Ans. Both offer and acceptance must be communicated. But this communication may be either express or may be implied from the conduct of the parties and surrounding circumstances. The mere fact that a merchant has goods exposed for sale is an implied offer to sell, and the taking or ordering of the goods by a purchaser is an implied acceptance of the offer.

22. What is the distinction between a void contract and a voidable one?

Ans. A void contract is one that is altogether invalid and unenforceable and can never be anything else but invalid and unenforceable. A voidable contract is one which has validity, but which may be evaded. It may be ratified and turned into an enforceable contract by ratification or into a void contract by repudiation.

23. May a person enter into a contract under any name that he chooses?

Ans. A person may assume a fictitious name in entering upon a contract, provided it is not done with intent to defraud.

24. What is the Statute of Frauds?

Ans. The Statute of Frauds is an old English Statute which required certain classes of agreements to be put into writing in order to prevent fraud and in order that the exact meaning of the parties might be ascertained. This statute has in some form or another been re-enacted in every state and when a particular agreement which the law requires to be in writing is sought to be enforced, it is said to be contrary to the Statute of Frauds if there is no written memorandum of the agreement.

25. What is a breach of contract?

Ans. A breach of contract is a failure or refusal to carry out the terms of the contract.

26. In what ways may a breach of contract arise?

Ans. From a refusal to perform an executory contract before the time arrives for its performance.

By failure to carry out the terms of the contract, and

By a party rendering the contract impossible of performance by his own act.

27. What remedies has one party for breach of contract by the other?

Ans. He may sue for damages caused by the breach, or in certain limited cases, he may compel a specific performance of the contract.

28. The law of what place generally governs the contract?

Ans. The general rule in interpreting or enforcing a contract is that the law of the state where the contract was made governs the contract.

29. How is the place of making the contract determined?

Ans. The place where the contract is made is the place where the contract is finally consummated. Since the contract takes the form of offer and acceptance, and is completed by acceptance, the place of acceptance is the place where the contract is made.

30. What exceptions are there to the general rule that the place where the contract is made governs it?

Ans. Where the contract specifically names the place of performance, then the law of the place where the contract is to be performed, governs it.

Transfers of land or of any interest in land are governed by the law of the state where the land is situated.

In the sale of personal property when the contract is to be completed by delivery of the goods, the law of the place of delivery governs the contract.

CORPORATIONS.

1. What is a corporation?

Ans. A corporation is an artificial being created by law and possessing powers conferred upon it by charter either expressly or as incidental to its existence.

2. What are the general advantages of incorporating a business?

Ans. It enables men to invest small or large amounts of capital in a business without any risk beyond the amount of the capital stock subscribed for. With a few exceptions, there is no liability on the part of a stockholder in a corporation for debts of the corporation, beyond the amount of the capital stock subscribed for. If the stock is fully paid up, there is no liability at all on the part of the stockholder for debts of the corporation. If the stock is not fully paid up he is liable for a sum equal to the amount of his unpaid stock subscription. Labor debts are usually excepted by statute, and stockholders of a corporation are liable for all debts of the incorporation incurred for labor, no matter what the amount of their subscription, or whether their stock is fully paid up or not. There is also added liability on the part of holders of stock in banking corporations. In most states, holders of bank stock are liable to an amount equal to double the par value of their stock subscriptions. A member of a co-partnership is liable for all of the debts of the co-partnership no matter how small his individual interest in the co-partnership may be. Hence the advantage of the corporation. Many enterprises, especially very large ones, would be impossible without the corporation. The individual hazards would be so great as to deter anyone from undertaking them. Moreover the corporation

is in a way a perpetual being. The death of one or more of its members has no effect upon its continued existence and operation.

3. What are the principal classes of corporations?

Ans. Public, private and quasi-public corporations. Public corporations are governmental institutions for the regulation of public affairs, such as municipal and village corporations. Private corporations are those created to regulate and conduct private interests, such as manufacturing, mercantile corporations and the like. Quasi-public corporations are those, which though created to regulate a private business incidentally benefit and accommodate the public, such as railroad companies, canal companies, depot companies, etc. They are given certain governmental powers such as the right to condemn land for right of way, etc., and are subject to certain governmental checks and surveillance such as the Inter-State Commerce Act, the Railway Rate Law, etc., but they are not public corporations.

4. How are private corporations created?

Ans. By the state, by charter granted under a general law, or by special statute. Congress may create corporations for the District of Columbia.

5. What constitutes the charter of a corporation?

Ans. Generally, the articles of incorporation are the general or the special act under which they are issued.

6. What is the usual method of forming a corporation?

Ans. The drafting of the articles of incorporation, in compliance with the provisions of the act under which it is sought to incorporate, the signing of the articles by the number of incorporators required by the act, a certain number of whom are usually required to be residents of the state of incorporation, the subscription by them to the capital stock to the amount required by the act, the filing and recording of the articles with the Secretary of State, and with the county clerk in the county in which the corporation has its principal office, the first meeting of stockholders upon statutory published notice unless such notice is waived, the election of directors and officers, and the adoption of by-laws.

7. What are the usual requirements as to the contents of the articles or certificate of incorporation?

Ans. The name of the proposed corporation, its place of business, the act under which it seeks to incorporate, the specific purpose or purposes for which it desires to organize, the total amount of its authorized capital stock, the number and value of shares into which such capital stock is divided, the amount of stock subscribed for, and in what manner paid in, the names and residences of the incorporators and the amount of stock subscribed for by each.

8. What is the territorial extent of the powers of a corporation?

Ans. A corporation being the creature of the state creating it, has no powers beyond the limits of that state, and cannot do business in another

state except as it may be permitted by such foreign state under regulations provided by it or as it may be protected by the federal Constitution when engaged in inter-state commerce.

9. What are the powers of a corporation in the state of its creation?

Ans. A corporation may do only those things which are permitted to it by its charter or which are incidental to its existence. All other acts are called "ultra vires."

10. May a corporation hold title to real estate?

Ans. Unlike a partnership which cannot hold title to real estate as a partnership, a corporation may own the legal title to land, though in some states the amount of land and the time for which it may hold it, is limited.

11. May a corporation make a contract with one of its members or stockholders?

Ans. A corporation is a being separate and distinct from the individuals composing it, and unless prohibited by charter may make contracts with any of its stockholders. It may also make contracts with its directors or officers if such contracts are made in good faith and are free from any fraud upon the stockholders.

12. What power has a corporation to borrow money and issue promissory notes?

Ans. In the absence of charter prohibition a corporation may borrow money and issue evidence of indebtedness as may an ordinary individual, though usually the power of officers to borrow money and issue notes is regulated by the by-laws of the corporation. But a corporation may not borrow money or issue notes for a purpose not contemplated in its charter.

13. May a corporation become guarantor or surety for another's debts?

Ans. Usually it may not unless this is especially permitted by its charter. Such an act is ultra vires as it would be risking the capital of the corporation in an enterprise not contemplated by its charter. And so a corporation generally may not become an accommodation indorser upon another's paper.

14. May a corporation hold stock in another corporation?

Ans. Generally it may not unless the power is expressly conferred upon it by its charter. This would be an ultra vires act in that it would enable the corporation to get control of enterprises not within the scope of its authorized powers. But a corporation may take stock in another corporation as collateral for or in payment of debts to it. And a corporation may sell its property for stock in another corporation for the purpose of distributing such stock among its own stockholders in winding up the company.

15. May a corporation hold, buy and sell its own stock?

Ans. In most states it may, provided it does so in good faith and so as not to defraud creditors, and in all cases a corporation may take its own shares for payment of debts due to it.

16. Is a corporation liable for the wrongful acts of its agents or employes?

Ans. It is, provided the act was done in the regular performance of the officer's or agent's duties as an employe of the corporation.

17. What is the effect of the dissolution of a corporation upon claims against it?

Ans. In the absence of statutory provision, no claim can be maintained against a corporation after its dissolution, but in most states the incorporated acts specifically provide that for the purposes of suit the corporation shall continue to exist for a certain period after formal dissolution.

18. What is the capital stock of the corporation?

Ans. The money or property fixed as the basis for conducting the business of the corporation.

19. What are shares of stock?

Ans. The subdivisions of the capital stock fixing the interests of the individual stockholders in the property and profits of the corporation.

20. Of what nature is the property designated by shares of stock?

Ans. A share of stock is always classed as personal property, even though the property of the corporation consists exclusively of real estate.

21. What is a stock certificate?

Ans. It is the evidence of the ownership of shares of stock. It is not the stock itself, any more than a bill of lading or a warehouse receipt is the property itself.

22. Are certificates of stock negotiable?

Ans. They are not, and the purchaser of a certificate gets only such right to the shares as the original holder thereof had.

23. What is the difference between common stock and preferred stock?

Ans. Common stock is entitled only to prorata dividends from the profits of the corporation without priority or preference. Preferred stock has a preferred dividend which must be paid before any dividend is issued on the common stock, even though such preferred dividend exhausts all the profits of the corporation and leaves none to be paid on the common stock. When the profits will not justify, it is manifest that no dividends should be paid even on preferred stock.

24. What are the respective rights of creditors and preferred stockholders?

Ans. The outside creditor has a preference over the preferred stockholder and the corporation's debts must be paid before the preferred stock is entitled to any dividends.

25. What is treasury stock?

Ans. Stock issued to the corporation itself and held by it. This is frequently done to provide for expected increase in the available capital of the business, by selling treasury stock.

26. What is watered stock?

Ans. Stock issued at face value when in fact it is not represented by actual property of the corporation.

27. When is stock considered as being issued?

Ans. When it has been subscribed for. Actual issue and delivery to the stockholder is not necessary, the certificate being merely the evidence of the ownership of the shares.

28. What may be received in payment of stock subscription?

Ans. Anything of value. It may be money, or property, or services, or the release of an obligation.

29. What is meant by over-issued stock?

Ans. Stock issued in excess of the authorized amount. It has no value though the purchaser may recover damages from the corporation or from the officers who isued it.

30. Who is a stockholder in a corporation?

Ans. One who is a member of the corporation, by reason of his owning one or more of its shares of stock. He is also called a shareholder. The actual holding of a certificate is not necessary. One may be a stockholder, though no certificate has been issued to him. The fact of legal ownership of the shares, is the test of whether or not one is a stockholder.

31. When does a stockholder in a corporation cease to be such?

Ans. When he parts with his stock, when his shares are forfeited, when the corporation is dissolved, or when he is expelled, in those corporations where expulsion is possible, such as religious corporations, social clubs and the like.

32. Have stockholders any title to the property of the corporation?

Ans. They have not. The property is the property of the corporation which is an artificial being. The stockholder merely owns the right to share in the management and profits of the corporation, and to share in the residue of the assets, upon dissolution, after the debts are paid.

33. Has a stockholder any title to the profits of the corporation?

Ans. Only when a dividend has been actually declared. Until then, undivided profits are the property of the corporation.

34. What are the rights of a stockholder as against a creditor?

Ans. They are clearly subordinate to those of the creditor. He is entitled to share in profits and assets only after the corporation debts are paid.

35. Is there any trust relation between stockholders, or between a corporation and its stockholders?

Ans. There is not. There exists a trust relation between co-partners and between individual partners and the co-partnership, but in a corporation the stockholders stand in the same relation to each other and to the company as do the parties to any other contract. The officers and directors of a corporation do, however, stand in a trust relationship toward the stockholders.

36. Must the subscription to stock be in any particular form?

Ans. No. Any form will do, so long as it shows clearly the intent to subscribe. And subscribers may be bound even if the form prescribed by the statute or the charter is not exactly followed. The subscription is not invalidated by a mistake in the name of the corporation, so long as it is clear which corporation was intended.

37. Must the subscription be in writing?

Ans. A written subscription is not generally necessary and a verbal agreement to subscribe may be enforced.

38. Who may subscribe for corporation stock?

Ans. Anyone who is capable of making contracts generally, except that corporations which are prohibited from holding stock in other corporations may not subscribe.

39. What is meant by forfeiture of stock?

Ans. It is the usual remedy which the corporation exercises when the unpaid stock subscription is not paid after being called in. Upon forfeiture, the stock reverts to the corporation or is sold and the proceeds applied upon the amount due. The power of forfeiture must be exercised in exactly the manner prescribed by statute in order to be valid, and all the details of notice, publication, etc., must be carefully carried out.

40. What are, and what are not good defenses to an action attempting to enforce a call for unpaid subscriptions?

Ans. A material change in the corporate design if made without the subscriber's knowledge or consent will release him. So also will the corporation's failure to live up to the conditions of the contract with the subscriber, and generally when the rest of the stock is not subscribed for, the subscriber will not be liable. But an immaterial change in the corporate design, or a change in the corporate charter which merely increases the powers of the corporation, or delay in carrying out the purposes of the corporation will not operate as a good defense to defeat the enforcement of a call. When there has been fraud or misrepresentation in securing the subscription, the subscriber has a good defense on which to base his failure to comply with the call.

41. What constitutes a release by the corporation to the subscriber from his stock subscription?

Ans. Any agreement with the corporation based upon an adequate consideration and consented to by all the rest of the subscribers.

42. What generally are the rights of stockholders in a corporation?

Ans. They may attend and vote at all stockholders' meetings, vote for directors, share in the profits and dividends and in the assets after dissolution.

43. What is the status of a stockholder to whom the corporation is indebted?

Ans. He stands in the same relation to it as does any other creditor, and has the same rights. There is nothing inconsistent in his relation both as a stockholder and as a creditor of the corporation.

44. What are the stockholder's rights with respect to the books of the corporation?

Ans. He has a right to inspect them personally, or by agent, or attorney, and to make memoranda or copies from them if he chooses. But this right must be exercised only in a reasonable manner, and at reasonable times, and must not impede the corporation's business.

45. What is the purpose of stockholders' meetings and when and where should they be held?

Ans. Stockholders' meetings are necessary in order to express the corporation's will, and should be held at such time and place as is fixed by the statute or the charter and by-laws of the corporation. But no stockholder who takes part in a meeting held at any other time and place or who assents to it can afterwards object to the legality of such meeting. When no time and place are fixed, meetings may be held upon call, but this call may be waived by all the stockholders' consent or by their attendance at the meeting, and any irregularities in the call are also waived by such attendance.

46. What business may be transacted at stockholders' meetings?

Ans. If the meeting is a general one called in pursuance of the statute or the laws of the corporation, anything may be done which comes within the scope of the legitimate corporate business. If the meeting is a special meeting, only such business may be transacted as is stated in the call and notice of such special meeting, though this restriction may be waived by the consent of all of the stockholders.

47. Under what theory is a corporation stockholder liable to creditors for unpaid subscriptions to corporation stock?

Ans. The capital stock of a corporation is a trust fund for the benefit of its creditors, and no part of it can be withheld if there are enough assets to pay creditors. And the liability of the stockholder for unpaid subscriptions can not be waived by agreement with the corporation, so far as the rights of creditors are concerned.

48. What is the position of the stockholder who accepts stock as a bonus?

Ans. He is liable for the full face value of the stock to those who have become creditors after the bonus stock has been issued, but is not

liable to those who were already creditors when the stock was issued to him.

49. What is the position of the stockholder who has received stock in payment for property or services?

Ans. If the property or services are reasonably worth the amount put upon them, he will not be liable, but if the value put upon either the property or the service is grossly excessive, he will be liable for the difference between their reasonable value and the face value of the stock, so far as credtiors are concerned.

50. What is the general liability for debts of the corporation due for labor?

Ans. In nearly all of the states, stockholders are personally liable for all debts due by the corporation for labor, even though the stock is fully paid up. As to just what services are meant, depends on the wording of the statute in each particular state. This has been held to include debts to agents, bookkeepers, reporters, editors, civil engineers, foremen, etc., but not to the general officers of a corporation, managers, secretaries, etc., nor to professional men such as lawyers and consulting engineers nor to independent contractors.

51. What is the liability of a promoter for debts contracted in forming the corporation, which debts have been assumed by the corporation?

Ans. He is liable as an individual unless the creditor agrees to look to the corporation for payment.

52. When persons associate themselves as a corporation, but the incorporation is defective or incomplete, what is their position as against creditors.

Ans. They stand in the position of co-partners, but creditors dealing with them as a corporation cannot question their corporate existence, unless the thing omitted or done defectively is something which by statute is a prerequisite to corporation existence. In such case, creditors may recover against the attempted incorporators as against partners.

53. What is the effect of a transfer of the stock upon the stockholders' liability?

Ans. If the transfer is made in good faith, while the corporation is solvent, the transferrer is not liable for unpaid balances. But if the transfer is made during insolvency of the corporation for the purpose of avoiding responsibility, the transferrer is still liable and the statutes of Illinois, Iowa, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, Ohio, Oregon, Rhode Island and Tennessee make the transferrer in any case liable for debts contracted before the transfer. And a bona fide transferree who buys stock without notice of any unpaid portion thereof, cannot be held liable.

54. In order that a transfer may relieve the transferrer from liability, what must be done?

Ans. Everything that is necessary to complete the transfer. When a transfer must be registered upon the books of the corporation, this should be done.

55. Who may enforce this stockholders' liability?

Ans. Any creditor or the assignee of a creditor may enforce it. But after the appointment of a receiver for the corporation, the receiver has the exclusive right to sue upon the stockholders' liability. Whether a creditor who is also a stockholder may enforce such liability depends upon the statute of the particular state where the corporation is organized. An assignee for the benefit of creditors may enforce the liability.

56. How may the capital stock of a corporation be increased or diminished?

Ans. The capital stock of a corporation can neither be increased nor diminished except by the authority of the state as expressed in the statute creating the corporation. This act usually provides for the formalities necessary to such increase or reduction. It is usually done in the form of an amendment to the corporation charter, signed by stockholders representing two-thirds of the stock issued, and filed with the secretary of state and the county clerk. An unauthorized issue of stock is the same as overissued stock and is void. The holder of unauthorized stock is merely a creditor of the corporation to the extent to which he has paid for such stock.

57. May the Board of Directors of a corporation increase or reduce its capital stock?

Ans. The authority to increase or reduce the capital stock of a corporation must be exercised by the stockholders and not by the directors, though an unauthorized increase or reduction of the stock by the Board of Directors may subsequently be ratified by the stockholders.

58. What right has a shareholder in a corporation to sell his stock?

Ans. The right to convey or mortgage attaches to corporation shares as it does to all other personal property, and ceases only upon the dissolution of the corporation, and no by-law is valid that puts an unreasonable restraint upon such conveyancing or mortgaging. But a provision in a certificate that the stock shall be first offered to the corporation before it may be sold has been upheld, and usually the statute provides that the corporation shall have a lien upon the shares for debts owing to the corporation by the stockholder, and the stockholders may make a binding agreement among themselves not to sell their stock for a certain period, or to offer it first to a particular person.

59. May a director sell his shares?

Ans. He may, subject to the lien that the corporation has upon the stock for any debts he may owe to the corporation.

60. As between the buyer and seller of stock, who is entitled to the dividends?

Ans. The buyer, in the absence of agreement to the contrary, gets all dividends that are declared upon the stock after his purchase, no matter when they have been earned. But when the seller has sold the stock and has received in addition to the purchase price from the buyer a pro rata dividend up to the time of sale, the buyer may recover such sum back if the expected dividend is afterwards not declared.

61. To what extent has the corporation a lien upon its stock?

Ans. In most states the statutes provide that the corporation may enforce a lien upon its stock for unpaid stock subscription and for debts owing to it by the stockholders, and the statutes provide the manner of its enforcement, and all persons are presumed to have notice of such lien and to act subject to it. Such liens may also arise because of contracts between the corporation and the shareholder, and the corporation may also provide for such liens in its by-laws. But third persons are not presumed to have notice of such contracts or by-laws, and in order to enforce such lien against a bona-fide holder for value, the corporation must show actual notice of the contract or the by-law. An unauthorized by-law may have the effect of creating a lien when the shareholder against whom the lien is sought to be enforced, participated in the enactment of such by-law. The corporation is entitled to a lien on the shares of a stockholder who is a member of a partnership for debts owing it by the partnership.

62. Does the statute of limitations bar the corporation's lien on stock for debts?

Ans. No. The corporation may enforce its lien even though it could not sue to recover for the debt, owing to the running of the statute of limitations against it.

63. What rights has the purchaser of a stock certificate to have the stock transferred to him upon the books of the corporation?

Ans. He has an absolute right, and can compel such transfer. But a mere pledge of the certificate conveys no such right. A trustee or an executor of a deceased shareholder and the purchaser at an execution sale have all the right to have the stock transferred upon the books of the corporation, though in the case of the former, the corporation may demand the surrender of the old certificate before it makes the transfer and issues the new certificate.

64. What are the rights of a bona-fide holder of shares assigned in blank?

Ans. He acquires the right of a shareholder just the same as though the blank had been filled in, and his name inserted in the assignment.

65. If the corporation has no notice of the assignment of the shares and issues dividends to the former owner, is it liable to the purchaser?

Ans. No, unless it has some notice of the unregistered assignment. The buyer should protect himself by having his ownership registered upon the books of the corporation.

66. A corporation is organized with $30,000 common stock and $20,000 preferred stock. Later the corporation is dissolved and an audit shows its assets to be $50,000 and its liabilities $30,000. How would the assets be distributed?

Ans. Preferred stock can be and usually is preferred both as to dividends and capital; under these conditions therefore, after the outside liabilities are paid the preferred stockholders would receive the remaining $20,000 and the common stockholders would receive nothing. If the stock is not actually preferred as to assets, all stockholders would share alike in the distribution.

PARTNERSHIPS.

1. What is a partnership?

Ans. A partnership is a legal relation based upon express or implied contract of two or more competent persons to unite their property, labor, or skill in carrying on some lawful business as principals for their joint profit.

2. What is meant by the capital of a partnership?

Ans. The capital of a partnership is the total of money or property contributed by the members of the firm for the purpose of carrying on the partnership business.

3. What is the character of the relation existing between partners?

Ans. Partners occupy a fiduciary or trust relationship to each other and each partner must exercise the same fairness and good faith toward a co-partner as a trustee must toward the persons for whom he acts as trustee. A partner must not obtain private benefits from firm transactions without the consent of his co-partners. He cannot buy up claims against his firm, and such purchase would be equivalent to payment of the claim by the firm. He cannot acquire an adverse title or interest in firm property. If he accepts commissions for influencing firm transactions, the commissions belong to the firm, and profits made with the use of firm moneys are the property of the firm.

4. In case of the death of one of the partners, in whom does the title to partnership property vest?

Ans. When a partner dies, the title to all personal property held by the partnership vests in the surviving partner, or partners, subject to a trust, that an accounting will be made to the deceased partner's estate of such share as he would have been entitled to. If the deceased partner held title to any of the firm's real estate, such title vests in his heirs subject to a trust in favor of the creditors of the firm and the surviving partners.

5. What are the relative liabilities of a new partner and a retiring partner?

Ans. In most states a new partner is liable for only those debts of the firm which were contracted after his becoming a member of the firm, though he may by agreement render himself liable for the firm's previous obligations. A retiring partner is liable for all debts of the firm contracted while he was a member, and for all debts contracted after his retirement, with persons who have previously dealt with the firm and have not had actual notice of his retirement, and with all new creditors who have not had either actual or constructive notice of his retirement.

6. Who should give notice of dissolution?

Ans. When the partnership is terminated by mutual agreement, each of the partners should give notice, and where only one of the partners retire, it is to his interest to give notice of dissolution. A dormant or secret partner need not give notice of dissolution except to those who actually knew of his relation to the firm as a partner.

7. In what order are partnership assets distributed when divided by the court?

Ans. When the courts wind up a partnership and distribute its assets, they will apply them first to the payment of the partnership debts, as creditors of the firm have priority over creditors of the individual partners. If the firm assets are not sufficient to satisfy the firm's debts, the creditors of the firm will then share proportionately with the individual partner's creditors in the assets of such individual partners.

8. Is contribution to the capital necessary to constitute one a partner?

Ans. No. Frequently partnerships exist where one partner furnishes the capital and another the services or experience. Common ownership of the profits and not of the capital stock is the test of partnership.

9. May one be liable as a partner when no partnership exists?

Ans. Where one holds himself out as a partner or allows others to hold him out as a partner without denying his membership in the firm, he will be liable as a partner. This occurs most frequently in the case of a member who has retired from the firm, and fails to give notice of his retirement, and permits the business to continue under the old name.

10. What are the two principal classes of partnerships?

Ans. General partnerships and special partnerships. In a general partnership the members of the firm associate to carry on some business and do all things in common relating to that business. Special partnerships are frequently formed to do some particular special act or transaction in common.

11. What are the two principal classes of partners?

Ans. An ostensible partner is one who is held out generally as a partner. He shares in the profits and losses and is known generally as a partner. A silent or dormant partner is one whose connection with the firm is unknown. The latter is one who also takes no active part in the business of the firm. An active partner as distinguished from a dormant partner is one who does take an active part in the firm's business. A silent partner is also one whose connection with the firm is unknown and who exercises none of the rights of a partner except to share in the partnership profits. A nominal partner is one who is apparently a partner but is not really one. He may have his name in the firm, but exercises none of the rights of a partner.

12. Who may become partners?

Ans. In general, all who may enter into contracts may become partners. An infant may become a partner, though he may at any time prior to majority, or ratification after majority, rescind his partnership contract. Generally, corporations may not be partners, though in some cases it is permitted by the corporation's charter.

13. **How many persons may become partners?**

Ans. There must manifestly be at least two persons in a partnership, and in the absence of statute prescribing the number, there is no limit to the number of persons who may associate as partners.

14. May a partnership own real estate?

Ans. No. The real estate may be in the names of the several partners but not in the name of the firm. "Jones & Smith" cannot hold real estate, but John Jones and Robert Smith may hold real estate as co-owners, purchased with partnership funds.

15. What becomes of the capital of a partnership upon dissolution of the firm?

Ans. Unless required to pay debts, and unless the articles of copartnership provide for its distribution, the capital of a partnership upon dissolution is given back to the individual members of the firm, in proportion to the amount each contributed before any profits are divided, and a partner contributing nothing to the capital is entitled to no part of it upon its distribution.

16. How is distribution of the capital made when there has been a loss?

Ans. When the partnership business has been conducted at a loss, such loss is apportioned to the partners in proportion to their individual contributions to the capital, before it is divided.

17. Who is entitled to the use of the firm name after the dissolution of the partnership?

Ans. If the name is a fictitious name, either party, in the absence of any agreement with respect thereto, may use the firm name after dissolution, but if the name is not fictitious and contains the names of the partners, neither partner would have the right to use the name of the firm in such a way as to lead the public to believe that the original firm still continued.

18. If the firm is dissolved by the death of one of the partners, who is entitled to the firm name?

Ans. When one of the partners dies, some courts have held that the firm name belongs to the surviving partners, but others have held that it is an asset of the partnership and should be treated just as other assets are.

19. Where should the partnership books be kept?

Ans. All partnership books of account should be kept at the principal office of the firm. No member of the firm has a right to keep the firm's books at his individual residence or place of business unless there has been an agreement to that effect.

20. Can a partner recover from the firm for services rendered to it?

Ans. Each partner is presumed to use his best efforts to further the firm's business and cannot recover for services rendered unless there has been an agreement that he shall be compensated therefor. He must be satisfied with his share of the profits, though the partners may, of course, agree upon certain compensation for certain services.

21. When a partnership is dissolved, what powers, if any, remain with the members of the partnership?

Ans. Upon the dissolution of a partnership, the powers of the members of the firm to make new contracts or incur new obligations ceases, but they are still vested with authority to do all things necessary to wind up the business. They may collect moneys owing to the firm, pay its debts, bring and defend suits, complete unfilled contracts, make compromises, sell property, and do all things necessary to close up the partnership business.

22. What is the distinction between partners and co-owners?

Ans. Co-owners are not agents for each other; either may transfer his interest so as to put his purchaser in his place; they do not necessarily share in profits and losses, and their relation may arise without there being an agreement.

23. What is a limited partnership?

Ans. A limited partnership is a partnership in which the liability of some of the partners is limited to a fixed amount, while that of the others remains the same as in an ordinary partnership. Limited partnerships are created by statute and the terms under which they are created and do business are defined by the statutes of the state where they are permitted to exist. A limited partnership must not be confounded with a joint stock company or a partnership association limited, which partake more of the character of corporations than they do of ordinary partnerships.

24. How is a limited partnership formed?

Ans. Limited partnerships exist only by virtue of statutes authorizing them and such statutes must be closely followed. They usually provide that a certificate be executed by the partners published for a certain period, and filed with the Secretary of State, and with the County Clerk of the County where the partnership has its principal office. Such certificate must usually contain the names of the partners with their residence; indicate who are general partners and who are special partners; give the name under which the firm is to do business, which name must in some states contain the names of all the general partners with the addition of the words "and Co." or "Limited"; give the amount of capital contributed by special partners; state the kind of business for which the company is organized; and when it is to begin and terminate.

25. Has a special partner prior right over other partners or over creditors in distribution of the capital surplus on the winding up of a firm?

Ans. A special partner has no prior right over the claims of the creditors of a firm, nor has he a prior right over the claims of other partners unless there has been an agreement to that effect.

VARIOUS BUSINESS LAW PROBLEMS.

1. What is a Bill of Sale?

Ans. A Bill of Sale is a written instrument, generally under seal, which evidences the transfer of title to personal property.

2. If under a contract of sale of goods, the seller delivers them to a common carrier for transportation to the buyer, who would bear the loss if the goods were injured in transit, the carrier not being at fault?

Ans. If the carrier is mentioned in the agreement or selected by the buyer, the title to goods shipped passes upon delivery to the carrier and in such case the risk of transit is the buyer's and not the seller's, and if the goods are injured without fault of the carrier, the loss will be upon the buyer.

3. What is a bailment?

Ans. Bailment is the delivery of goods to some other person, under a contract that the purpose for which the goods are delivered will be executed and that the goods shall then be returned to the owner or dealt with according to his direction. The one who delivers the goods for the purpose of bailment is called a bailor and the one with whom goods are bailed is called a bailee.

4. What is a pledge?

Ans. A pledge is a bailment delivered by a debtor under an agreement that it shall be held as security for the debt, and returned when the debt is paid.

5. What is the extent of a common carrier's liability?

Ans. A common carrier is liable as an insurer for all goods intrusted to his care and will be responsible for their loss or damage unless such loss or damage is the result of an Act of God or the negligence of the shipper, or the inherent quality of the goods or some exercise of public authority.

6. What is a bill of lading?

Ans. A bill of lading is a receipt given to the shipper by a carrier of goods, showing that the goods mentioned are to be transferred to the consignee under the agreement contained therein.

7. What is a chattel mortgage?

Ans. A chattel mortgage is a mortgage of personal property. It is a conveyance of personal property to secure a debt, absolute in form, but conditional in fact, which vests the title in the mortgagee, subject to be defeated by a payment of the debt which it secures.

8. What is the necessity for the renewal of a chattel mortgage?

Ans. The statutes of many of the states render a chattel mortgage invalid unless it is renewed at the expiration of a certain time, usually one year, or unless a new affidavit is made within a certain period, usually thirty days, preceding the expiration of the mortgage.

9. What is meant by the right of redemption?

Ans. The right of redemption is the right which the mortgagor has to secure the release of the property mortgaged by the payment of the debt. The right of redemption may be sold or assigned by the mortgagor and constitutes the mortgagor's equity of redemption.

10. What is a guaranty?

Ans. A guaranty is a contract whereby one person promises to answer for the debt, default, or miscarriage of another, if the other does not.

11. What is the distinction between a guaranty and an indorsement?

Ans. Both guaranty and indorsements are conditional promises to answer for the debt, default or miscarriage of another, but the liability of a guarantor is broader than the liability of an indorser. An indorser is relieved from liability by failure of prompt presentment, and due notice of dishonor; a guarantor is relieved by such failure only when he has suffered loss thereby.

12. What is the distinction between a surety and an indorser?

Ans. A surety's obligation is the same as that of his principal, and he is not entitled to notice of default, while an indorser is relieved by failure to make prompt presentment and to give due notice of dishonor. A surety upon a promissory note stands in the same relation as does an accommodation maker.

13. What is real property?

Ans. Real property includes all things that are embraced in the terms, lands, tenements and hereditaments.

14. What is real estate?

Ans. Real estate is the quantity of interest which a person has in real property. The term real estate is now commonly used interchangeably with the term real property.

15. What is an abstract of title?

Ans. An abstract of title is a summary of all of the recorded documents and facts of record which affect the title to a certain piece of real estate.

16. What is a deed?

Ans. The word deed as commonly used in connection with real estate means a written instrument conveying title to real estate.

17. Must a deed be witnessed?

Ans. Every deed must be witnessed before it can be recorded. Some states require but one witness to a deed while others require two.

18. When does a deed take effect?

Ans. A deed takes effect only upon delivery and acceptance.

19. What is a mortgage?

Ans. A mortgage is a conveyance of property as security for a debt.

20. How is a mortgage executed?

Ans. A mortgage of real estate is executed in the same manner as is a deed. It must be signed, sealed, acknowledged, and delivered.

21. When must a note be presented in order to hold the endorsers liable?

Ans. It must be presented on the day it is due, either at the bank where it is payable or at the place of business of the maker, or at his residence within a reasonable hour on that day.

22. When should presentment be made of a bill or note which falls due on Sunday or upon a legal holiday?

Ans. Where days of grace are allowed, presentment of a bill or note which matures on Sunday or a legal holiday must be made upon the day preceding the last day of grace. Where there is no grace, presentment of such bill may be made upon the first day following the Sunday or holiday upon which the instrument matures.

23. When does the statute of limitations begin to run upon a demand note?

Ans. A demand note in the great majority of states is due as soon as made, and a right of action accrues immediately, thus causing the statute to run from the date of the note. This is true even if the note bears interest.

24. Will the certification of a forged check make the bank liable?

Ans. If the signature is forged, the certification of the check binds the bank, but certification of a check will not make the bank liable if the body of the check is forged or the check raised. Certification binds the bank only as to those things within its knowledge, and it is presumed to know the signature of its depositors. But genuineness of the indorsers' signatures is not guaranteed by certification.

25. Is the giving of a note for the amount due a payment?

Ans. The execution and acceptance of a note or draft is not a payment in performance of a contract to pay until the note is paid, unless by agreement the note or draft is accepted in discharge of the debt.

26. When the note is given and accepted in absolute satisfaction of the sum due, what is its effect?

Ans. It discharges the debt and if the note is not paid, no suit can be brought upon the original debt, but the creditor must sue upon the note.

27. If the note is not taken in absolute satisfaction of the debt, what is its effect?

Ans. The debt is not discharged until the note is paid. If the note is not paid, the creditor may sue upon the note, or he may sue upon the original indebtedness.

28. What is meant by accommodation paper?

Ans. Accommodation paper is a bill or note which is made, accepted, or indorsed by one party for another without consideration, but merely for the purpose of loaning his credit to the party accommodated.

29. What is an account stated?

Ans. An account stated in an agreement between two parties who have had previous dealing, as to the amount owing by each to the other, and as to the balance due, coupled with an express or implied promise to pay such balance.

30. What is the Statute of Limitations?

Ans. Formerly a right under a contract or a debt never lapsed by the expiration of time, but nearly everywhere it is now provided by statute that such right or debt shall be barred after the expiration of a certain time, so that no suit can be brought after such interval to recover on the debt. Such statutes are known as statutes of limitations.

31. When does the statute of limitations begin to run?

Ans. The statute of limitations begins to run from the time a right of action accrues upon the contract; that is, from the time when the party may begin suit upon the debt or contract.

32. What terminates the running of the statute of limitations?

Ans. When a suit is brought upon a debt, the running of the statute is terminated, and the statute begins to run again from the time of rendering the judgment. A new promise or an acknowledgment of the debt also operates to stop the running of the statute and it begins to run anew from the time of making the new promise or acknowledgment. A part payment on the debt has the same effect as a new promise or acknowledgment with respect to the running of the statute. The payment begins to run anew from the time of the last interest payment.

33. A Sends to B, in settlement of an undisputed account amounting to $1,000, a check for $850, bearing the inscription "In full payment of account." B deposits the check in his bank for collection but credits A's account only with $850. Is A liable for the balance? If so, why? If not, why not?

Ans. A is liable for the balance unless there are some further factors entering into the case but not specified in the question. No consideration is given for the remaining $150, and endorsement of a check is evidence of the receipt of the money represented by that check, but a receipt is not conclusive evidence of full payment, neither is a part payment in cash of a stated debt sufficient to establish a full discharge of the debt.

If B set up a counter-claim for the difference at the time of sending the check, and A deposited the check without disputing the counter-claim within a reasonable length of time, B would not be held liable for the balance because it would be held that A accepted the check and counter-claim in full accord and satisfaction of the debt.

34. What is a negotiable instrument?

Ans. An instrument is negotiable when delivery, or indorsement and delivery will transfer title to it and the property it represents from one person to another.

35. What are the provisions of the Negotiable Instruments Law in the case of an instrument signed by one as agent without authority to bind his alleged principal?

Ans. Under the law, one who signs as agent for an alleged principal is not exempt from liability thereon, by the mere addition of words describing him as agent or as filling a representative character.

36. What words are words of negotiability?

Ans. Any words which express the maker's intention that the bill or note may be transferred by indorsement or delivery are words of negotiability. The most customary words of negotiability are the words "or order" following the name of the payee. But the following orders and promises contain words of negotiability: "Pay to the order of," "I promise to pay to the order of," "Pay to bearer," "I promise to pay to bearer."

37. What are considered material alterations under the Negotiable Instruments Law?

Ans. Material alterations are any alterations which change the date; the sum payable, either for principal or interest; the time or place of payment; the number or the relations of the parties; the medium of currency in which payment is to be made; or which add a place of payment where no place of payment is specified; or which alter the effect of the instrument in any respect.

38. What is the "Sale of Goods in Bulk Act"?

Ans. The "Sale of Goods in Bulk Act" is a statute in force in a number of states, including Massachusetts, Connecticut, Tennessee, Washington, Michigan, Wisconsin, Maryland and New York, the object of which is to protect creditors against fraudulent conveyances of goods in bulk by debtors. The act varies in some of its provisions in the various states, but the chief feature in the act as it is in force in all of the states enumerated is that sales of goods in bulk are declared void as to creditors unless such creditors shall have had certain notice, usually five days, of such proposed sale, before it is made.

39. What is meant by the right of stoppage in transit?

Ans. It is the right a seller of goods may have to stop the carrier to whom he has delivered goods consigned to a purchaser from delivering the goods, and to get possession of them again for the purpose of enforcing his lien upon them for his purchase price.

40. What is a receiver?

Ans. A receiver is an officer whom the court appoints in certain cases to act for it in taking charge of property to prevent its waste or destruction, collect the proceeds and distribute them among the persons entitled to them.

41. What is an assignment for the benefit of creditors?

Ans. An assignment for the benefit of creditors is a transfer by a debtor of all of his property to some person or corporation in trust for his creditors, with authority to convert the property into money and divide the proceeds among the creditors.

42. What is bankruptcy?

Ans. Bankruptcy is a state of insolvency or inability to pay one's debts.

43. What is a bankrupt?
Ans. A bankrupt is one who is unable to pay his debts.

44. What is insolvency?

Ans. Insolvency in its popular meaning is synonymous with bankruptcy.

45. What is the object in passing bankruptcy laws?

Ans. Bankruptcy laws are passed for the purpose of securing to creditors an equal and fair distribution of the bankrupt's property and to enable unfortunate bankrupts whose bankruptcy is not fraudulent to begin business anew.

46. When is a person insolvent?

Ans. A person is insolvent whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, or removed, or permitted to be concealed or removed with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts.

47. What is meant by a discharge in bankruptcy?

Ans. A discharge in bankruptcy is the release of the bankrupt from all the debts that are provable except those that are excepted.

48. What is a trustee in bankruptcy?

Ans. A trustee in bankruptcy is the person who is intrusted with duty of collecting, administering and distributing the estate of the bankrupt among his creditors under the direction of the court.

49. What are the duties of a trustee in bankruptcy?

Ans. Trustees in bankruptcy are required to pay over to the estates under their control all interest received by them upon property of such estates; to collect and reduce to money the property of the estates for which they are trustees, under the direction of the court, and to close up

the estates as expeditiously as is compatible with the best interests of the parties in interest; to deposit all moneys received by them in one of the designated depositaries; to disburse money only by check or draft on the depositaries where it has been deposited; to furnish such information concerning the estates and of their administration as may be requested by the parties interested; to keep regular accounts showing all moneys received and from what sources and all moneys paid out and upon what accounts; to lay before the final meeting of creditors detailed statements of the administration of the estate; to make final reports and file final account fifteen days before the final meeting of creditors; to pay dividends within ten days after they have been declared by the referee; to report to the court in writing the condition of the estate and the moneys on hand and such other details as may be required within one month after appointment and every two months thereafter unless otherwise ordered; to set aside the bankrupt's exceptions and report the items and their value as soon as practicable.

50. Having come to an adjustment of certain accounts between them, Howard Pine gave unto Samuel Barnes his note for $577.19. The time of the settlement was January, 1912. After the note had been signed by Pine and delivered to Barnes and the parties had separated, Barnes observed that the note was written upon an old printed form of a note on which there had been printed as part of the date, the figures "190." In filling in the note, the figure "2" had been added so that the note apparently read "January, 1902." To correct this, Barnes took his pen and made a figure one through the cypher. What effect had this upon the note, if any?

Ans. The Negotiable Instruments Act provides that where a negotiable instrument is materially altered without the assent of all parties thereon, it is avoided, except as against a party who has himself made, authorized or assented to the alteration and subsequent indorsers. But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration he may enforce payment thereof according to its original tenor. A change in date is a material alteration, but as the change of date on this note was not an alteration, but the correction of a mistake, and if it could be proved that the change was merely to make the note conform to the original intention of the parties, it would not avoid the note, and it would be still enforceable against the maker.